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Supreme Court, U.S.
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No. 99-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1999

VANESSA ARMSTRONG,
Petitioner,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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September 2, 1999

35 pp

QUESTIONS PRESENTED

Do federal laws concerning the federal student loan program, 20 U.S.C. §§ 1071 *et seq.*, preempt state consumer protection laws that permit a borrower to raise misconduct by the seller as a defense against repayment of a loan that has been arranged by the seller for the lender?

PARTIES TO THE PROCEEDINGS BELOW

Petitioner is Vanessa Armstrong, a former student of NBS Automotive School, a for-profit vocational school operated by Market Tire Educational Services, Inc., in the District of Columbia. Petitioner was plaintiff and appellant in the proceedings below. Defendants-appellees were Secretary of Education Richard Riley, in his official capacity as reinsurer of petitioner's loan under the Higher Education Act of 1965; Bank of America NT&SA, a California corporation that purchased petitioner's guaranteed student loan as trustee; California Student Loan Finance Corporation, a California corporation organized for the purpose of purchasing student loans under the Higher Education Act ; and the Educational Credit Management Corporation, a Minnesota corporation that is the assignee of the guaranty for petitioner's loan under 20 U.S.C. §§ 1078, 1085(j), which was originally held by the Higher Education Assistance Foundation, Inc., a Minnesota corporation.

The Accrediting Council for Continuing Education & Training, Inc., a Virginia corporation which was formerly known as the "Council for Noncollegiate Continuing Education" or "CNCE," was a defendant in the proceedings below but was not a party on appeal because the claims against it arose under a separate cause of action that was settled in the district court.

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OPINIONS BELOW

The opinion of Court of Appeals for the District of Columbia Circuit is reported at 168 F.3d 1362, and was amended at 177 F.3d 1036. The opinion and amendment are reprinted in the Appendix to this petition at pages 1a-22a. The decision of the District Court for the District of Columbia is reported at 980 F. Supp. 53, and is reprinted in the Appendix at pages 23a-58a.

JURISDICTION

The judgment of the District of Columbia Circuit was entered on March 6, 1999. A timely petition for rehearing was denied on June 4, 1999. *See* Appendix at 20a. This Court has jurisdiction over both cases under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant provisions of the Truth in Lending Act, 15 U.S.C. § 1603(7), the Higher Education Act of 1965, 20 U.S.C. §§ 1077, 1078, the Federal Trade Commission Rule on Preservation of Consumer Claims and Defenses, 16 C.F.R. Part 433, student loan regulations, 34 C.F.R. §§ 682.200, 206, and D.C. Code 28-3809, the are set forth in the Appendix, 59a- 71a.

STATEMENT OF THE CASE

Last year, over fourteen thousand actions were filed in the federal courts to collect on loans issued under the federal student loan program. The number of student loan cases in the federal courts nearly tripled from 1996 to 1998, and has increased twelve-fold since 1995.[1] These cases now represents 60% of the civil cases brought by the United States. *Id.* at 26. In addition to these federal suits, private loan holders bring actions in state court, and federal agencies conduct

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[1]Federal Judicial Center, 1998 Judicial Business of the United States Courts, 145, Table C-2A.

administrative proceedings to collect loans by intercepting tax refunds or garnishing borrowers' salaries.[2]

In a significant portion of these proceedings, the borrowers allege that the loan was procured through fraud by the school that received the loan proceeds. Under state common law and statutes, these allegations are a defense or set-off to collection. For years the federal courts have struggled with the question of whether the Higher Education Act preempts these state defenses but have been unable to reach any consensus on the issue. Although the courts have almost uniformly concluded that federal law leaves the enforceability of these loans to state law, they are divided on the question of whether federal law preempts state laws that recognize defenses when schools arrange loans for lenders.

In the decision below, the District of Columbia Circuit held that federal law implicitly preempted these state law defenses because federal authorities decided that a Federal Trade Commission rule that provides protection similar to these state laws should not be enforced with respect to these student loans. This decision is contrary to *Puerto Rico Consumer Affairs Dep't v. Isla Petroleum Corp.*, 485 U.S. 495, 501 (1988), in which this Court held that state law is not preempted merely because federal authorities have decided that comparable federal laws should not remain in effect. Moreover, this Court's decisions make clear that preemption requires "actual conflict" between federal and state law, and such conflict does not exist merely because there is no federal standard in effect governing the conduct addressed by state law. *See, e.g., Freightliner Corp. v. Myrick*, 514 U.S. 280 (1995).

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[2] *See* 20 U.S.C. § 1095a (authorizing Secretary and guaranty agencies to issue orders garnishing wages); 31 U.S.C. § 3720A (authorizing the Secretary and guaranty agencies to collect on the loans by having the Internal Revenue Service withhold tax refunds owed to borrowers).

This Court should grant certiorari because the District of Columbia's ruling is inconsistent with this Court's preemption rulings, and in conflict with the Seventh Circuit's opinion in *Veal v. First American Savings Bank*, 914 F.2d 909 (1990), which states that state law defenses are not preempted by the Higher Education Act.

A. The Guaranteed Student Loan Program.

The Guaranteed Student Loan Program ("GSLP") is a incentive program established by the Higher Education Act of 1965, 20 U.S.C. § 1071-1146a ("HEA"). *See* 34 C.F.R. § 682.100 (1992).[3] Under the GSLP, the federal government encourages lenders to make loans for student tuition, fees, and expenses by paying interest subsidies and reinsuring the lenders' losses in the event of default, provided that certain federal requirements are met. *See* 20 U.S.C. §§ 1078, 1087-1. The value of the loans issued annually under the GSLP has steadily grown from approximately $9 billion in 1986, to almost $20.5 billion in 1998.[4]

Approximately 20-30 percent of all GSLP loan funds have gone to proprietary and vocational schools offering relatively short term programs (six months to a year) in trades or job skills.[5] Investigations into the GSLP program have repeatedly found that many vocational schools have engaged in

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[3] In 1992, the GSLP was renamed the "Federal Family Education Loan Program." Pub. L. No. 102-325, § 411, 106 Stat. 510 (1992). The Circuit Court's opinion it used the name of the program when the loans at issue were made, Appendix at 2a n.*, and we follow the same practice in this petition.

[4] The College Board, *Trends in Student Aid: 1982 to 1992* at 4, Table 1 (Sept. 1992).

[5] *Id.* at 3, 9, Table 6.

fraud or other abuses to induce students to sign GSLP loans.[6] Many of the students enrolled in vocational schools are unable to repay their loans. For example, in 1987, the loan default rate for students at vocational schools was 39%, in contrast to a 10% default rate for borrowers at four year schools.[7] Numerous suits have been filed by former students challenging the enforceability of GSLP loans arranged by such vocational schools.[8]

The schools accused of fraud in these cases typically worked with lenders to market loans to students. The HEA permits lenders to use schools as their agents for marketing loans, but does not require that they do so. All schools participating in the loan program must disseminate information on federal financial assistance programs, 20 U.S.C. § 1092(a) (1988), and provide a "statement" or "certification" verifying the student's enrollment and financial needs. *Id.* § 1078(2)(a)(i); 34 C.F.R. § 682.603 (1988). Schools may choose to become more involved in the loan making process by referring students to particular lenders or by performing tasks

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[6] *Abuses in Federal Student Aid Programs, Hearings before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs*, 101st Cong., 2d Sess., S. Hrg. 101-659, Pt. 2, 153-58 (1990); Office of Inspector General, U.S. Department of Education, SEMIANNUAL REPORT TO CONGRESS, No. 22, October 1, 1990-March 31, 1991, at 9-23.

[7] *Abuses in Federal Student Aid Programs*, S. Rep. 102-58, 102d Cong., 1st Sess. 2 (1991); General Accounting Office, *Analysis of Student Default Rates at 7,800 Postsecondary Schools*, GAO/HRD-89-63BR, at 15 (July 1989).

[8] *See, e.g., Tipton v. Secretary of Education*, 768 F. Supp. 540 (S.D.W.Va. 1991); *Keams v. Temple Technical Institute, Inc.*, 807 F. Supp. 569 (D. Ariz. 1992); *Williams v. National School of Health Technology, Inc.*, 836 F. Supp. 273 (E.D. Pa. 1993); *Bogart v. Nebraska Student Loan Program*, 313 Ark. 656, 858 S.W.2d 78 (1993).

in the loan-making process normally performed by lenders, such as completing and having the borrower sign the promissory note. *See* 34 C.F.R. § 682.206(a), (b). However, if the lender has the school perform "substantial functions or responsibilities normally performed by lenders before making loans," student loan regulations provide that the school is considered to have "originated" the loan. *Id.* § 682.200(b). Since 1976, the student loan regulations have singled-out school-originated loans for special treatment by limiting lenders' ability to rely on representations by schools that originate loans on their behalf. *See id.* § 682.206(a)(2). While the origination regulations permit lenders to delegate loan making responsibilities to schools, they also indicate that "such a practice is discouraged." 41 Fed. Reg. 4499-4500 (1976).

Neither the HEA nor the regulations define the defenses that may be raised on GSLP student loans. The statute contains several provisions expressly preempting state laws on specified issues, such as usury laws, 20 U.S.C. § 1078(d), infancy defenses, statute of limitations, and limits on recovery of collection costs. *Id.* § 1091a. It does not, however, purport to displace state law on other issues. The Department of Education has consistently maintained that federal law does not "occupy the field" with respect to student loans, but leaves issues concerning the defenses that may be raised to state law, unless state law is in actual conflict with federal law. *See Tipton v. Secretary of Education*, 768 F. Supp. 540, 543 (S.D.W.Va. 1991) (*quoting* Department of Education brief); *accord Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1248 n.9 (D.D.C. 1992), *rev'd on other grounds*, 27 F.3d 573 (D.C. Cir. 1994), *vacated*, 115 S. Ct. 2573 (1995), *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995) (rejecting field preemption claim); *Keams v. Tempe Technical Instit., Inc.*, 807 F. Supp. 569, 573-78 (D. Ariz. 1992), *rev'd on other grounds*, 39 F.3d 222 (9th Cir. 1994) (same). In 1992, both Congress and the Secretary of Education considered proposals that would

preempt state laws that allow borrowers to raise the misconduct of schools as a defense to enforcement of a student loan. *See* H.R. Rep. No. 447, 102d Cong., 2d Sess. 508 (1992); 57 Fed. Reg. 60,304 (1992). Neither of these proposals, however, was adopted. *Id.*

B. State and Federal Laws Protecting Borrowers From Fraud By Sellers Arranging Financing.

Student loan borrowers who allege that they have been defrauded by schools marketing loans for lenders have sought to raise the schools' misconduct as a defense to repayment under state common law and consumer protection statutes. State common law generally provides that, where a seller acts as agent for a lender in arranging financing to pay for the seller's goods or services, the lender may be held responsible for misrepresentations made by the seller to secure the sale. *See, e.g., Calvert Credit Corp. v. Williams*, 244 A.2d 494, 496 (D.C. 1968); J. Alperin and R. Chase, CONSUMER LAW: SALES PRACTICES AND CREDIT REGULATION § 599 at 319-21(1986)(describing major cases). In addition, consumer protection statutes in many states provide that, if a seller and lender cooperate in arranging consumer loans, the lender is subject to claims and defenses arising from the seller's misconduct in the underlying transaction, at least up to the loan amount. *See, e.g.*, D.C. Code 28-3809 (lender subject to defenses arising from consumer sales); J. Fonseca, HANDLING CONSUMER CREDIT CASES, § 2.18-20, at 69-84 (3d ed. 1986) (describing state law protections); Hudak & Carter, *The Erosion of the Holder in Due Course Doctrine; Historical Perspective and Development - Part II*, 9 UCC L.J. 235, 243-60 (1976) (surveying state legislation). These laws prevent lenders and sellers who jointly arrange financing from using the holder-in-due course rule or loan provisions to "cut off" defenses arising from the sellers' misconduct. Instead, state

law generally provides that, if the seller steered the borrower to the lender, the lender cannot assert that the loan is a separate contract and the borrower is required to repay the loan even if the sale was induced by the seller's fraud.

This principle was incorporated into federal law in 1975 when the Federal Trade Commission ("FTC") adopted a trade rule on "Preservation of Consumers' Claims and Defenses" or "Holder Rule." The Holder Rule provides that, if a for-profit seller and lender are related by a business arrangement, or if there is a referral from the seller, the loan must include a Notice stating that the holder is subject to all claims and defenses that the borrower has against the seller. *See* 16 C.F.R. § 433.2 (1999). The Notice becomes part of the loan contract, enforceable under state contract law, so that when the lender (or its assignee) seeks repayment of funds paid to the seller, it "stands in the shoes of the seller," and cannot collect for goods or services that were never delivered or were sold through fraud. *See* 41 Fed. Reg. 20023 (1976). State laws and the FTC Holder Rule are based on the determination that allowing lenders to "cut-off" consumer defenses is unfair, and that lenders are in the best position to prevent and seek redress for misconduct by sellers who act on their behalf. *See* 40 Fed. Reg. 53,506, 53523-24 (1975); Note, *Direct Loan Financing of Consumer Purchases*, 85 Harv. L. Rev. 1409, 1413 (1972).

The Department of Education has warned, in policy statements and regulations, that student loans may be subject to defenses based on the school's misconduct when the school acts as the lenders' agent or "originates" the loan.[9] Federal

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[9] Letter of Acting Assistant Secretary Kenneth D. Whitehead to Hon. Stephen J. Solarz, May 19, 1988, quoted in *Jackson v. Culinary School of Washington, Ltd.*, 27 F.3d 573, 584-85 (D.C. Cir. 1994); *see also* 34 C.F.R. § 682.604(f)(2)(iii) (providing that students should be counseled that they

(continued...)

authorities have also stated that student loan holders may be subject to claims and defenses based on the school's misconduct even where the school's involvement in loan making was not extensive enough to constitute an "origination" relationship. In 1976, the Office of Education issued a memorandum notifying all lenders and educational institutions that federal student loans must comply with the recently promulgated FTC Holder Rule. Appendix at 75a-79a. Consequently, the notice advised that, when private, for-profit schools refer students to lenders, or have an formal or informal business arrangement with lenders, student loans must include the Notice set forth in the Holder Rule to make holders of the loan subject to claims or defenses arising out of fraud or other misconduct by the school. *Id.* at 77a.

However, by 1990 a controversy had developed over whether 1982 Amendments to the Truth in Lending Act ("TILA") exempted student loans from the FTC Holder Rule. The FTC Holder Rule was adopted pursuant to the Federal Trade Commission Act, but the Rule borrows the definition of "Finance Charge" in the TILA to identify transactions involving the extension of credit. *See* 16 C.F.R. § 433.1(d) (Holder Rule covers transactions where "[a] cash advance which is received by a consumer in return for a 'Finance Charge' within the meaning of the [TILA]"). "Finance Charge" is defined as interest or any other "charge payable directly or indirectly by the consumer" as a cost of credit, 15 U.S.C. § 1605(a); 12 C.F.R. § 226.4. In 1982, Congress exempted student loans from the TILA. *See* 15 U.S.C. §

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[9](...continued)
cannot raise school-related defenses on a loan, "other than a loan made or originated by the school"); 55 Fed. Reg. 48327 (1990) (describing "longstanding view" that if an origination relationship exists, the school's failure to deliver services provides the student a defense).

1603(7), *as amended by* Pub. L. 97-320, title VII, § 701(a), 96 Stat.1538 (1982). This exemption was introduced "to eliminate duplicative paperwork" because the Higher Education Act requires disclosures similar to those required by the TILA. *See* 20 U.S.C. § 1083(a); S. Rep. No. 536, 97th Cong., 2d Sess. 42, *reprinted in* 1982 U.S. Code Cong. & Admin. News 3096 (discussing § 701 of S. 1720 which became § 701 of Pub. L. 97-320). These Amendments did not alter the TILA's definition of "Finance Charge." Nonetheless, in April 1990, an FTC staff member, citing the 1982 Amendments, wrote a letter to a private attorney stating that the FTC "staff's current enforcement position" is that student loans are not covered by the FTC Rule. Appendix at 81a. In September 1990, the Seventh Circuit issued a decision stating that student loans are exempt from the FTC Holder Rule. *Veal v. First American Savings Bank*, 914 F.2d 909, 914 (7th Cir. 1990).

In the meantime, in June 1990, the FTC staff member retracted the letter he had written just two months earlier, stating that it appeared to be based on an "incorrect" premise and the Commission staff wanted a "chance to thoroughly research the issue." Appendix at 82a. In 1991 and again in 1993, the FTC staff issued opinion letters rejecting the argument that the 1982 TILA Amendments exempt student loans from the Holder Rule. *Id.* at 84a-94a. In doing so, the FTC staff expressly rejected *Veal*, which had not offered any analysis to support its assertion that student loans are exempt from the FTC Holder Rule. *Id.* at 90a-91a.

In 1993, the Department of Education also embraced the view that the protections of the Holder Rule apply to student loans. Beginning in 1994, all lenders were required to use a standard promissory note form prescribed by the Department of Education. *See* 20 U.S.C. § 1082(m)(1). When

the Department developed the standard form in 1993, it rejected arguments that the language of the Holder Rule should not be included in the note and, instead, mandated that all student loan forms contain a clause stating that, if the proceeds of the loan "are used to pay tuition and charges of a for-profit school that refers loan applicants to the lender or that is affiliated with the lender by common control, contract or business arrangement," any holder of the loan "is subject to all claims and defenses" that the borrower could assert against the school. *Id.* at 6a-7a.

C. The Decision Below.

Petitioner Vanessa Armstrong enrolled in a vocational school, NBS Automotive School in the District of Columbia, which she alleges engaged in misrepresentation to induce her and other students to enroll. Petitioner further alleges that the school arranged her student loan for her lender by handling all communications with petitioner concerning the loan; the school prepared her loan application, specified the type of loan, determined the loan amount, selected the lender, presented the loan agreement to her for signature, and forwarded the promissory note and loan agreement to the lender. Appendix at 8a.

NBS filed for bankruptcy in 1990. In 1991, plaintiff Armstrong brought a separate action against the parties claiming a right to enforce her NBS loan, with jurisdiction arising under 28 U.S.C. §§ 1331 and 1367, and 20 U.S.C. § 1082(a)(2). She alleged that she and other students were entitled to raise NBS's fraud as a defense to enforcement of the student loans because of NBS's role in originating the loans.[10]

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[10] Plaintiff alleged that the school misrepresented that it was properly accredited and brought a class claim against the school's accrediting agency for misrepresenting the school's accreditation. In response to the accrediting agency's motion for summary judgment, the district court found

(continued...)

More specifically, Armstrong relied on a District of Columbia statute which provides that "[a] lender who makes a direct installment loan for the purpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller if" the lender "acts at the express request of the seller" and "the seller participates in preparation of the loan instrument." D.C. Code § 28-3809(a). Petitioner Armstrong also presented alternative theories for preserving these defenses, but these theories are not at issue here.

In a 1993 opinion the district court concluded that relief under the District of Columbia statute is preempted because federal law permits schools to perform loan making functions when they "originate" the loan, and applying the District's statute would attach liability to "functions that clearly are contemplated by the HEA." *Armstrong v. Accrediting Council for Continuing Education and Training*, 832 F. Supp. 419, 430-31 (D.D.C. 1993)). On appeal, the Circuit Court vacated the judgment and remanded the case for the district court to expressly consider whether it should exercise jurisdiction over the pendent state law claims since petitioner's claim under federal law had been dismissed on other grounds. 28 U.S.C. § 1367(c). Appendix at 9a-10a, 27a, *Armstrong v. Accrediting Council for Continuing Education and Training*, 84 F.3d 1452 (D.C. Cir. 1996). On remand, the district court decided to exercise supplemental jurisdiction. *Armstrong v. Accrediting Council for Continuing Education & Training*, 950 F. Supp. 1

(...continued)
that the evidence was sufficient to show that the school was not properly accredited, but concluded that other factual issues precluded summary judgment in favor of petitioner and members of the class. *See Armstrong v. Accrediting Council for Continuing Education & Training*, 961 F. Supp. 305 (D.D.C. 1997). The accrediting agency subsequently settled the class claim.

(D.D.C. 1996). The court granted defendants' motions to dismiss again in 1997, but did not reach the issue of preemption of the District statute because it agreed with defendants that a choice of law clause in the loan contract allowed the lenders to avoid the District's consumer protection laws. Appendix at 29a-35a.

On appeal, the District of Columbia Circuit held that federal law preempted the District's consumer protection statute because "in the late 1980s" there was a federal policy that "protected lenders from such defenses" unless their loan making activities constituted an "origination relationship" under federal law. Appendix at 2a, 4a-5a. Under this purported federal policy, "origination" as defined by the Department, was the only situation in which borrower defenses were preserved. *Id.* at 5a. State laws, like D.C. Code 28-3809(a) were preempted, according to the Circuit Court, because they apply to situations that do not necessarily satisfy the federal definition of origination and, therefore, "would extend lender liability beyond school origination relationships." *Id.* at 16a-17a.

The District of Columbia Circuit's opinion, which was significantly amended in an order denying reconsideration, asserted that the source of this preemptive federal policy was the FTC staff's decision not to enforce the FTC Holder Rule with respect to student loans during the period from 1982 to 1992.[11] The Secretary of Education's Brief represented that the

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[11] The panel's initial decision identified the TILA as "the source of the Holder Rule," Appendix at 12a, and characterized the 1982 TILA Amendments as a congressional effort "[t]o further encourage private lenders to make vocational school student loans." *Id.* at 4a. The reconsideration motion noted that these assumptions were erroneous, because the Holder Rule was issued pursuant to the FTC's authority under

(continued...)

FTC staff had stopped enforcing the Holder Rule after the 1982 TILA Amendments. *See Id.* at 21a, 22a. The Circuit Court maintained that "[e]nding enforcement of the Holder Rule with respect to GSLP loans," not only ended federal enforcement actions, but had "the effect of protecting lenders from claims and defenses students could raise against their schools," unless the lender fell within the Department of Education's "origination policy." *Id.* 4a-5a. This preemptive policy ended by 1992, under the Circuit Court's theory, because in 1991 "the FTC renewed enforcement of the Holder Rule with respect to GSLP loans," and the Secretary of Education subsequently included language from the Holder Rule in the standard loan notes. *Id.* at 6a. According to the District of Columbia Circuit, during the ten years prior to 1992, the FTC staff's decision not to enforce the FTC Holder Rule created an "actual conflict" between state and federal law that preempted state laws like D.C. Code 28-3809(a) "so long as the lenders avoided school-origination relationships." *Id.* at 5a.[12]

(...continued)
Section 5 of the FTC Act, see 40 Fed. Reg. 53,506, 53,523 (1975) (identifying 15 U.S.C. § 41 *et seq.*, as the source of the Holder Rule), and the legislative history of the 1982 TILA Amendments indicates that the purpose of the amendments was to eliminate duplicative disclosure requirements. The panel denied reconsideration, but it amended the opinion by deleting the passages quoted above and replacing the initial opinion's references to an FTC "nonenforcement policy" with references to the government's representation that there was a FTC staff *decision* to stop "enforcing the Holder Rule with respect to GSLP loans." Appendix at 20a-22a.

[12] Although defendants-appellees argued below that D.C. Code 28-3809 was preempted by federal law, the contention that a pre-1992 federal policy to preempt state law emerged from the FTC staff's decision not to enforce the Holder Rule or, alternatively, from the 1982 TILA Amendments that triggered the FTC staff's decision, was first advanced in the Circuit Court's (continued...)

REASONS FOR GRANTING THE WRIT

This Court should grant certiorari because the Circuit Court's preemption ruling is inconsistent with this Court's decisions. This Court's decisions have emphasized that the "actual conflict" required for preemption does not exist merely because federal law permits conduct or does not provide the same remedies as state law. To the contrary, conflict preemption must be based on an affirmative federal mandate or objective that would be significantly frustrated by state law. No such mandate exists here. Instead, the Circuit Court's decision displaces important state law protections based on a federal decision not to enforce an analogous federal rule.

In addition, this Court should grant certiorari to resolve the inconsistent decisions by the lower courts on this issue. Although the preemption issue has been percolating through the lower courts for more than a decade, the decisions have become increasingly fractured and confused, and this Court should resolve the important and recurring issue of whether state laws that protect borrowers under the student loan program are preempted.

I. THE RULING BELOW IS INCONSISTENT WITH THIS COURT'S DECISIONS ON PREEMPTION OF STATE LAW.

The Circuit Court's preemption ruling asserts that, because federal authorities decided not to enforce a FTC Rule preserving borrower defenses, state laws that provide analogous remedies are preempted. This reasoning is wholly inconsistent with this Court's decisions, which make clear that the state law is not preempted simply because federal authorities decide to

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[12](...continued)
opinion. We are not aware of any other decisions that adopt this approach to preemption.

stop enforcement of, or even repeal, analogous federal regulations.

A. The District of Columbia Circuit's preemption ruling is inconsistent with *Puerto Rico Consumer Affairs Dep't v. Isla Petroleum Corp.*, 485 U.S. 495 (1988). In that case, oil companies argued that a federal law eliminating federal regulation of gasoline production preempted state laws that imposed price controls after the federal controls expired. This Court unequivocally rejected the argument, and emphasized that the elimination of the federal legislation, with no statutory mandate restricting state authority, could not provide a basis for preemption. *Id.* at 501.

Isla Petroeum shows that the decision below is erroneous in two respects. First, it emphasizes that "[t]here is no federal pre-emption in vacuo, without a constitutional text or federal statute to assert it." *Id.* at 503. Unless there is a statute or regulation that can "plausibly be interpreted as *prescribing* federal preemption it is impossible to find that" federal law displaces state law. *Id.* at 501. The Circuit Court's decision below, however, does not identify any affirmative statutory or regulatory mandate as the basis for preempting state laws. To the contrary, the Circuit Court attributes preemption to a decision by FTC staff not to enforce the Holder Rule, even though the FTC staff has no statutory or regulatory authority to preempt state law through informal enforcement decisions.

Second, *Isla Petroleum* makes clear that a federal decision to recede from regulating a particular area does not implicitly preempt states laws concerning the same issue. In contrast, the Circuit Court's opinion, as amended, finds preemption in a decision by the FTC staff to discontinue enforcement of the FTC Holder Rule. Appendix at 4a, 20a-21a. If, as *Isla Petroleum* holds, the elimination of federal legislation is not sufficient to preempt state law, *a fortiori*, a

decision by agency staff to stop enforcement of a federal rule certainly does not preempt all comparable state law. Indeed, by concluding that an informal agency decision to not enforce a federal rule preempts state law, the Circuit Court's decision here is even more extreme than the reliance on legislative change that this Court found to be erroneous in *Isla Petroeum.*

Some respondents argued below that the 1982 TILA Amendments exempted student loans from the FTC Holder Rule. Appendix at 12a.[13] Respondents may argue that these 1982 Amendments also provide the federal mandate that supports the District of Columbia Circuit's ruling that state law protecting borrower defenses was preempted until 1992 (although they did not present such an argument below). This contention, however, is equally inconsistent with *Isla Petroleum*. Just as the elimination of federal price control legislation did not provide a basis for preempting state regulation, even if Congress decided to exempt student loans from the Holder Rule, this decision would not preempt state laws that provide similar relief. Moreover, there is no indication in the 1982 TILA Amendments or even in their legislative history, that Congress intended to preempt state laws allowing borrowers to raise misconduct by schools who arrange loans on behalf of lenders as a defense. *See* S. Rep. No. 536, *supra* at 42 (stating that exemption was intended to eliminate duplicative paperwork); 128 Cong. Rec. 19,916-17 (Aug. 9, 1982) (remarks of Rep. Heinz introducing original bill).

Consequently, the District of Columbia Circuit's decision is inconsistent with *Isla Petroleum* regardless of whether the 1982 TILA Amendments did, or did not, exempt student loans from the Holder Rule. We believe that the better view is that the Holder Rule applies to student loans, as the

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[13] Notably, the Secretary of Education did not make this argument below.

FTC staff has concluded in detailed opinion letters. *Id.* at 87a-90a, 93a. Moreover, student loans fall within the literal language of the Holder Rule, despite the 1982 TILA Amendments, *see* D. Pridgen, CONSUMER CREDIT AND THE LAW § 14.06[4][b] (1998) , and two district court decisions that have analyzed the issue in detail conclude that the 1982 TILA Amendments did not alter the scope of the Holder Rule. *See Morgan v. Markerdowne Corp.*, 976 F. Supp. 301, 311 (D.N.J. 1997) (citing *Jackson v. Culinary School of Washington*, 788 F. Supp. at 1249-51). However, regardless of whether the decision to discontinue application of the FTC Holder Rule was legislative or administrative, that decision should not preempt state laws unless accompanied by statutory or regulatory text that indicates a "clear and manifest" mandate to preempt state laws. *Isla Petroleum*, 485 U.S. at 500-01. No such text or mandate is present here.

B. The Circuit Court's preemption ruling here is also inconsistent with *Freightliner Corp. v. Myrick*, 514 U.S. 280 (1995), in which this Court held that "the absence of a federal standard cannot implicitly extinguish state common law." *Id.* at 282. In *Myrick*, the petitioner argued that because the National Traffic and Motor Vehicle Safety Act gave the Secretary of Transportation authority to establish a standard requiring antilock braking systems (ABS), and no standard was in effect, a state tort action alleging that the company's failure to use ABS was negligent was preempted because it was implicitly in conflict with federal law. This Court unequivocally rejected the argument, observing that there could be no conflict with federal law because the only relevant federal standard had been suspended. "First, it is not impossible for petitioners to comply with both federal and state law because there is simply no federal standard," and, second, there is no frustration of federal purposes because "[i]n the absence

of a promulgated safety standard the act simply fails to address the need for ABS devises at all." *Id.* at 289.

As in *Myrick*, there is no federal standard to create a conflict here. The decision by the FTC staff to not enforce the Holder Rule, at most, suspends the federal rule until enforcement resumes; it does not create a preemptive conflict with state law. Moreover, other provisions of federal law do not impose a federal standard. Neither the HEA nor GSLP regulations set forth the defenses that may be raised on student loans. Indeed, the Secretary of Education has affirmatively decided not to adopt regulations that would impose a federal standard. *See* 57 Fed. Reg. 60,304 (1992). There is also no statutory or regulatory mandate that lenders use schools as their agents for marketing loans. *See* Appendix at 3a, 7a (observing that lenders may limit their cooperation with schools to certain obligations mandated by the HEA and regulations). The Circuit Court's ruling in this case improperly preempts state law based solely on the absence of federal enforcement.

C. This Court's decisions also teach that "[o]rdinarily, state causes of action are not preempted solely because they impose liability over and above what is authorized by federal law." *California v. ARC America Corp.*, 490 U.S. 93, 105 (1989). In *California v. ARC America Corp.*, this Court held that state laws allowing indirect purchasers to bring antitrust actions that are not allowed under the Sherman Act are not preempted because nothing in federal law indicates that Congress intended to preclude states from authorizing antitrust remedies that went beyond those provided by federal law. In *English v. General Electric Corp.*, 496 U.S. 72 (1990), this Court held that statutory provisions that provide a federal remedy for whistle blowers who report violations of nuclear safety standards do not preempt state laws that provide exemplary damages and other benefits not available under federal law because there was no indication of "a clear

congressional purpose to supplant state law causes of action that afford broader relief." *Id.* at 88; *see also California v. Zook*, 336 U.S. 732, 733 (1948) (California law that provides a remedy that addresses the same conduct as federal remedy, but differs in details, is not preempted because "normally congressional purpose to displace local laws must be clearly manifested.").

The ruling below is inconsistent with these precedents. The federal remedies for the conduct at issue here are administered by federal agencies. The FTC has the authority to bring actions to enforce the Holder Rule under 15 U.S.C. §§ 45, 57b, but there is no private action for enforcement. *See Hollowary v. Bristol-Meyers Corp.*, 485 F.2d 986, 1002 (D.C. Cir. 1973). Similarly, the HEA authorizes the Secretary and guarantee agencies to bring remedial actions against schools for misrepresentation. *See* 20 U.S.C. § 1094(c) (1988); 34 C.F.R. §§ 668.71-.75, 682.700-.710 (1988). However, nothing in the HEA or the FTC Holder Rule even remotely suggests that remedies provided under federal law are *exclusive*, or that these remedies displace state laws that otherwise protect the rights of defrauded borrowers. The state laws at issue here, consumer protection statutes preserving borrower defenses on consumer loans, simply go beyond federal law on matters that are traditionally governed by state law. *See California v. Zook*, 336 U.S. at 734 (protection from fraud is among traditional state policy powers where presumption against preemption applies). This Court's cases make clear that such state laws are not preempted merely because they provide remedies that are not found in federal law. *See Medtronic, Inc. v. Lohr*, 518 U.S. 470, 495-496 (1996) (state common law action based on violation of federal standard is not "different from" federal law in a manner that justifies preemption).

D. This Court's decisions also recognize that courts should be reluctant to find preemption where state law protects

"legitimate and important state interests" that Congress may have contemplated would be protected by state law. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 599 (1974). State law generally serves as the primary source of law defining contractual rights and protecting against fraud. By holding that these protections are preempted because a federal rule addressing the same issues was not being enforced, the ruling below requires defrauded student loan borrowers to repay otherwise unenforceable loans, and allows lenders to use schools that defraud borrowers with impunity. As the District of Columbia Circuit observed, the results seem unfair, since lenders that permit schools to abuse the loan program are permitted to profit at the expense of the very students whom the loan program was intended to benefit. Appendix at 18a.

The Circuit Court's willingness to find such broad preemption of state protections is inconsistent with this Court's decisions holding that a federal interest in encouraging private transactions is not sufficient to preempt all state laws that may encumber those transactions. *See, e.g., United States v. Kimbell Foods*, 440 U.S. 715, 729-740 (1979) (federal interest in collecting small business loans does not warrant displacing state law); *United States v. Yazell*, 382 U.S. 341, 353(1966) (federal law governing small business loans does not justify overriding state laws "which generally reflect important and carefully evolved state arrangements designed to serve multiple purposes."); *Wallis v. American Petroleum Corp*, 384 U.S. 63, 68-70 (1966) (federal interest in assignability of leases under the Mineral Leasing Act does not preempt state law). The HEA is not a regulatory program, but seeks to create incentives for student loans by paying interest subsidies and providing insurance against defaults by borrowers. Nothing in the HEA, however, indicates that Congress intended to provide additional subsidies to lenders by allowing them to use unscrupulous agents to market their loans, or by requiring borrowers to bear losses from school misconduct that would be borne by lenders

if the loan was not reinsured by the federal government. To the contrary, the origination regulations suggest that lender delegation of loan making responsibilities to schools is tolerated, but discouraged. *See* 34 C.F.R. § 682.206. In addition, where Congress intended to free lenders from state laws that might hamper loan collection, like the statute of limitations, it did so explicitly. *See supra* at 5 (listing express preemption provisions). Congress' enactment of such specific preemption provisions "implies that matters beyond that reach are not pre-empted." *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 517 (1992) (plurality opinion); *accord id.* at 533 (Blackmun, J., concurring and dissenting in part). The HEA's mandate to encourage lenders to make student loans is not a mandate to protect lenders "at all costs." *Pacific Gas & Electric v. Energy Resources Comm'n*, 461 U.S. 190, 223 (1983).

II. THE LOWER COURTS' DECISIONS ON PREEMPTION OF STATE LAW UNDER THE STUDENT LOAN PROGRAM ARE INCONSISTENT.

The preemption issues in this action potentially arise in the collection of hundreds of millions of dollars in student loans. The law on these issues, however, has grown increasingly fractured as the lower courts have issued inconsistent decisions. Although the decisions do not present Circuit Court holdings in direct conflict, the divergent decisions emerging from the lower courts show that it is important for this Court to address this recurring issue.

The District of Columbia Circuit's preemption ruling in this case is inconsistent with the rationale of the Seventh Circuit's 1990 opinion in *Veal v. First American Savings Bank*, 914 F.2d 909, which states that state law defenses are not preempted. Like *Armstrong*, *Veal* involved student loan borrowers who sought to challenge the enforceability of their

student loans because the school that they attended fraudulently induced them to enroll. *Id.* at 911. The Seventh Circuit held that the students had failed to state a claim for relief because the Federal regulations upon which they relied, 34 C.F.R. §§ 682.512, 682.513, and the FTC Holder Rule, did not apply to their student loans, and because the state statute that they cited did not make the loan subject to defenses based on misconduct by the school. *Id.* at 914. Although the district court had ruled that the borrowers' claims were preempted, *id.* at 911, the Seventh Circuit did not endorse this ruling and added a footnote stating that, if sued by a lender in state court, the borrowers "would be entitled to assert any defenses available under state law that are applicable to his or her particular loan." *Id.* at 914-15 n.7.

The only other Circuit Court decision addressing preemption holds that federal law preempts state law, but its reasoning is inconsistent with the District of Columbia Circuit's decision here. In an unpublished decision issued shortly after *Armstrong,* the Eleventh Circuit held that state law is preempted if it is based on conduct that is "mandated *or contemplated by the HEA.*" *Eddie Bartels, et al. v. Alabama Commercial College, et al.*, No. 98-8885, slip. op. at 7 (11th Cir., June 29, 1999), 1999 U.S.App. LEXIS 19902 (italics added). Because federal law "expressly permits lenders to delegate lender functions to schools with which they enter into 'origination relationships,'" the Circuit Court concluded the "the Georgia law of agency and any other applicable state laws" are preempted to the extent they impose liability on loan holders for the "school's acts as purported agents of the lenders." *Id. Bartels* is inconsistent with the District of Columbia's opinion in this case because the Eleventh Circuit concluded that the HEA preempts state agency even when the school acts as agent for the lender in an "origination" relationship. *Id.* at 7-9 &n.7. The District of Columbia

Circuit's ruling below, however, states that school-originated loans are not subject to preemption, even if made during the 1982-1992 period, because the Department of Education had issued statements that endorsed the view that borrower defenses are preserved when the school acts as agent for the lender. Appendix at 5a.

The Arkansas Supreme Court has held that state claims are preempted where "it would be an impossibility for [lenders] to comply with the dictates of the HEA and not incur liability under state law." *Bogart v. Nebraska Student Loan Program*, 313 Ark. 656, 858 S.W.2d 78, 81 (1993); *accord Tipton v. Secretary of Education*, 768 F.Supp. 540 (S.D.W.Va. 1991) (concluding that state claim under West Virginia statute was preempted because court believed that state statute attached liability to actions by banks that are "expressly dictated by the federal act and regulations"). The District of Columbia's ruling here, however, goes farther because it concludes that state law is preempted not only when federal requirements make compliance with state and federal law impossible, but when federal law *permits* the conduct at issue.

The district court decision in *Morgan v. Markerdowne Corp.*, 976 F. Supp. 301 (D.N.J. 1997), illustrates how lower courts have struggled with the preemption issue. *Morgan* accepts the argument that state law may be impliedly preempted because it imposes liability greater than the liability imposed by federal law, but observes that state laws that provide the same relief as the FTC Holder Rule are not inconsistent with federal law. *Id.* at 319. Consequently, the district court held that state law defenses that are "equivalent to, but no more extensive than, existing federal defenses" set forth in the FTC Holder Rule are not preempted. *Id.* Thus, while the District of Columbia Circuit construed the FTC's decision not to enforce the Holder Rule as an affirmative basis for preemption, *Morgan* concludes that the Holder Rule reflects

a federal policy that exempts from preemption state laws that provide the same relief as federal law.

While these decisions do not show a classic conflict between the Circuits, they demonstrate that no coherent analysis of the preemption issue has emerged, despite the importance of this issue as a matter of federal law. This Court should grant certiorari to correct the District of Columbia's erroneous analysis and resolve the conflict among the federal courts.

CONCLUSION

This Court should issue a writ of certiorari to review the District of Columbia Circuit's rulings that federal law preempts the application of state laws preserving borrower defenses to federally reinsured student loans.

Respectfully submitted,

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September 2, 1999

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NO. 99-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1999

VANESSA ARMSTRONG,
Petitioner,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit

PETITIONER'S APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued October 2, 1998 Decided March 23, 1999

No. 97-5316

Vanessa Armstrong,
Appellant

v.

Accrediting Council for Continuing Education and
Training, Inc., et al.,
Appellees

Appeal from the United States District Court
for the District of Columbia
(No. 91cv03135)

Michael E. Tankersley argued the cause for appellant. With him on the briefs was *Alan B. Morrison*.

Anthony M. Alexis, Assistant U.S. Attorney, argued the cause for appellee Accrediting Council for Continuing Education & Training, Inc., et al. With him on the brief were *Wilma A. Lewis*, U.S. Attorney, *R. Craig Lawrence* and *Scott S. Harris*, Assistant U.S. Attorneys.

Henry S. Weinstock argued the cause and filed the brief for appellees Bank of America, N.T. & S.A., et al.

Mark E. Shure argued the cause and filed the brief for appellee Educational Credit Management Corporation.

Before: HENDERSON, RANDOLPH and TATEL, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* TATEL.

Concurring statement filed by *Circuit Judge* HENDERSON.

TATEL, *Circuit Judge*: In this case, we must decide whether appellant, a student who attended a for-profit vocational school with help from a federally guaranteed student loan, may assert the school's alleged fraud and failure to provide the education it promised as a defense against the lender's effort to collect the loan. Although federal student loan policy now recognizes school misconduct defenses against lenders who have "referral relationships" with for-profit schools, appellant obtained her loan in the late 1980s, a time when federal policy protected lenders from such defenses. Because we find no basis for applying the new standards retroactively to appellant's loan, we affirm the district court's dismissal of her claims for declaratory and injunctive relief.

I

Established by the Higher Education Act of 1965, the Guaranteed Student Loan Program provides interest rate subsidies and federal insurance for private lenders to make student loans. *See* 20 U.S.C. § 1078(a), (c) (1994).* To raise

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* The Guaranteed Student Loan Program has since been renamed the Federal Family Education Loan Program. *See* Higher Education Act Amendments of 1992, Pub. L. No. 102-325, sec. 411(a)(1), § 1071, 106 Stat. 448, 510. Throughout this opinion, we refer to the program as the GSLP, its name at the time appellant borrowed in 1988; where relevant, we cite

funds to make, i.e. "originate," additional loans, original lenders sell loans to other lenders on a secondary loan market. So-called "guaranty agencies" guarantee the loans, paying loan holders the amounts due and taking assignment of the loans if students default. *See id.* § 1078(c). The Secretary of Education "reinsures" the loans and ultimately reimburses guaranty agencies on a sliding scale. *See id.* § 1078(c)(1). Although guaranteed student loans often change hands many times, they are not considered negotiable instruments; neither repurchasers nor assignees become "holders in due course." *See Jackson v. Culinary Sch.*, 788 F. Supp. 1233, 1248 n.9 (D.D.C. 1992), *rev'd on other grounds*, 27 F.2d 573 (D.C. Cir. 1994), *vacated*, 515 U.S. 1139, *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995). Instead, subsequent holders assume loans subject to all claims and defenses available against original lenders. *Cf.* 34 C.F.R. § 682.508(c) (1988).

Students may use federally guaranteed student loans to attend "eligible" schools, including for-profit vocational schools. *See* 20 U.S.C. § 1085(a)(1) (1988). To establish eligibility, vocational schools must be accredited by a nationally recognized accrediting agency. *See id.* § 1085(c)(4). The Secretary requires eligible schools to perform certain functions to facilitate student access to guaranteed loans, including giving students information on loan availability, certifying student eligibility to participate in the federal loan program, and forwarding applications to lenders. *See* 34 C.F.R. §§ 668.41-.43, 682.102(a), 682.603 (1988).

Federal student loan policy has undergone two significant changes relevant to this case. The first began in 1979 when Congress amended the Higher Education Act to encourage

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law in effect in 1988.

lenders to market loans to for-profit vocational school students. *See* Higher Education Technical Amendments of 1979, Pub. L. No. 96-49, 93 Stat. 351. The 1979 amendments removed a ceiling on the federal interest subsidy paid to participating GSLP lenders, "making proprietary school loans, which had previously been considered as too risky, more attractive." S. Rep. No. 102-58, at 6 (1991) ("Senate Report"). Later amendments removed other limitations on student borrowers attending for-profit schools, increased aggregate loan limits, and allowed students who had not completed high school to use GSLP loans to attend accredited postsecondary schools. *See* Education Amendments of 1980, Pub. L. No. 96-374, 94 Stat. 1367; Higher Education Amendments of 1986, Pub. L. No. 99-498, sec. 425, § 1075(a), 100 Stat. 1268, 1359; *id.* sec. 481, § 1088, 100 Stat. 1268, 1476.

To further encourage private lenders to make vocational school student loans, Congress excluded GSLP loans from the Truth in Lending Act ("TILA"). *See* Pub. L. No. 97-320, sec. 701(a), § 1603, 96 Stat. 1469, 1538 (1982). As a result, the Federal Trade Commission stopped enforcing various TILA regulations against GSLP lenders, including the "Holder Rule." Adopted by the FTC in 1976, the Holder Rule requires purchase money loan agreements (loans supplying money for the purchase of goods or services) arranged by sellers to contain a notice to all loan holders that preserves the borrower's ability to raise claims and defenses against the lender arising from the seller's misconduct. *See* 16 C.F.R. § 433.2(a) (1998). For example, if a used car dealer who fraudulently sells a lemon also arranges the buyer's financing through a bank, the buyer may rely on the dealer's fraud as a defense against repaying the bank loan. Ending enforcement of the Holder Rule with respect to GSLP loans thus had the effect of protecting lenders from claims and defenses students could raise against their schools.

This lender protection from student suits had one major exception: where lenders delegated to schools "substantial functions or responsibilities normally performed by lenders before making loans." 51 Fed. Reg. 40,890 (1986); 34 C.F.R. § 682.206(a)(2) (1988). In such cases, the Department of Education's "origination policy" kicked in, treating the schools—not the banks—as the lenders that had effectively made the original loans. *See* 34 C.F.R. § 682.200(b) (1988). As a result, all subsequent loan holders (remember, there are no holders in due course) were subject to claims and defenses that students could raise against their schools. *Cf. id.* § 682.508(c). But so long as lenders avoided school- origination relationships, they could make and sell loans without fear that students could assert school misconduct as a defense against repaying their loans.

These changes in the Guaranteed Student Loan Program accomplished their purpose. Lending to for-profit school students mushroomed, increasing more than six-fold between 1982 and 1988. *See* Senate Report at 6-7. The changes also had unintended consequences. As a result of the GSLP's easy source of funding, large numbers of for-profit schools sprang up, admitted poorly prepared students, and offered shoddy programs. *See id.* at 2-3, 8-13. Graduates of these schools were often unable to get jobs. Default rates climbed dramatically, rising as high as 39%. *See id.* at 2. Because loan guaranty agencies were unable to keep up with growing default rates, many had to be bailed out by the Secretary. *See, e.g., id.* at 22.

In order to curb high default rates and protect students from for-profit school abuses, Congress initiated a second round of changes to the Guaranteed Student Loan Program in 1992. One change directed the Secretary to terminate GSLP eligibility of for-profit schools with consistently high default

rates. *See* Pub. L. No. 102-325, sec. 427(a), § 1085, 106 Stat. at 549 (redefining "eligible institution" to exclude schools with excessive default rates). As a result, many for- profit schools were eliminated from the program.

Congress also directed the Secretary to develop a "Common Guaranteed Student Loan Application Form and Promissory Note" specifying the contractual terms governing guaranteed student loans, and to study the possibility of permitting students to raise fraud-based state law defenses against repayment of student loans. *See id.* § 425(e), 106 Stat. at 546; *id.* § 1403, 106 Stat. at 817. Responding to these directives, the Secretary prepared a common promissory note and included in it a provision modeled on the FTC Holder Rule that was directed specifically at lenders affiliated with for-profit schools. *See* U.S. Dep't of Educ., Application and Promissory Note for Federal Stafford Loans (Subsidized and Unsubsidized) and Federal Supplemental Loans for Students (SLS) (1993) ("Common Promissory Note"). In fact, one year earlier the FTC had renewed enforcement of the Holder Rule with respect to GSLP loans. *See, e.g.*, Letter from Jean Noonan, Associate Director for Credit Practices, Federal Trade Commission, to Jonathan Sheldon, National Consumer Law Center (July 24, 1991) ("FTC Opinion").

Treating GSLP lenders like banks that allow used car dealers to arrange financing, the Holder Rule notice the Secretary included in the common promissory note, together with the FTC's renewed enforcement policy, made GSLP loan holders "subject to all claims and defenses" that the student borrower could raise against the school. Common Promissory Note. The notice applies where the loan is "used to pay tuition and charges of a for-profit school that *refers* loan applicants to the lender or that is affiliated with the lender by common control, contract or business arrangement." *Id.* (emphasis

added). According to the Department, "refers" means that a school, with a lender's knowledge, goes beyond "giv[ing] its students *information* on the availability of student loans" and "recommend[s] that the applicants seek loans from [a particular] lender." U.S. Dep't of Educ., Overview, Federal Trade Commission (FTC) Holder Rule 2, 3 (July 2, 1993) ("Overview, FTC Rule"). A school also "refers" loan applicants when it "contact[s] a particular lender to inquire whether that lender would be willing to make loans for *its own students*, and later include[s] this lender (if it responded positively) on its information list of lenders." *Id.* at 2. No referral relationship exists where a school simply "obtain[s] its lender information from third-party sources ... or from a more generalized school inquiry to a lender (*e.g.*, asking merely whether the lender is generally willing to make loans to trade school students in a particular state.)." *Id.* Although the common promissory note's Holder Rule notice expands lender liability beyond that authorized by the Department's origination policy, the Department has made clear that even under the notice's lower threshold lenders may protect themselves from school misconduct defenses by limiting their cooperation with schools to the few obligations mandated by the Higher Education Act and implementing regulations (i.e., providing students with information on loan availability, certifying student eligibility, and forwarding applications to lenders). *See* Dep't of Educ., Federal Trade Commission (FTC) Holder Rule: Questions/Answers 4 (July 27, 1993); 34 C.F.R. § 682.206 (1997).

The loan at issue in this case was made in 1988, during the time when federal student loan policy encouraged lenders to make GSLP loans to vocational school students and prior to inclusion of the Holder Rule notice in GSLP promissory notes. Appellant Vanessa Armstrong was recruited by National Business School, a for-profit vocational school operating in

Washington, D.C., to enroll in its automobile mechanic training program. With help from the school, Armstrong obtained a $4,000 GSLP loan from the First Independent Trust Company of California ("FITCO"). One of the largest sources of loans for students attending for-profit schools in the late 1980s, FITCO was singled out for its abuse of the Guaranteed Student Loan Program during the hearings that led to the 1992 revamping of federal student loan policy. *See* Senate Report at 21-24, 28.

According to Armstrong, a National Business School representative prepared her loan application, specified the type of loan, determined the loan amount, prepared the promissory note, selected FITCO as the lender, presented the loan agreement to Armstrong to sign, and forwarded the loan application and promissory note to FITCO. *See* Am. Compl. ¶¶ 22, 24. Printed on standard forms provided by FITCO's guaranty agency, the promissory note contained a choice of law clause that subjected the loan contract to the laws of the state of the lender, in this case California. Like other student loan promissory notes issued at the time, the note contained no Holder Rule notice. Armstrong alleges that the school and its accrediting agency, the Accrediting Council for Continuing Education & Training, Inc. ("ACCET"), represented that the school offered a nationally accredited program in 1988; in fact, she claims, its accreditation had expired a year earlier. *See id.* ¶¶ 2, 29-34.

Armstrong claims that National Business School failed to provide the promised training, equipment, and job placement services, "leaving [her] and other students to repay student loans for an education that they never received." *Id.* ¶ 2; *see also id.* ¶ 77. The school closed its doors in 1990 and filed for bankruptcy. Although the school had charged each student over $5,000, Armstrong and other former students who filed

claims in the bankruptcy proceedings each recovered only $900. *See* Compl. ¶ 26.

Armstrong filed suit in the United States District Court for the District of Columbia, asserting federal claims based on the FTC Holder Rule and the Department's school-origination policy, as well as pendant state law claims based on the District of Columbia Consumer Credit Protection Act ("CCPA") and common law contract doctrines. The complaint sought damages, restitution, and declaratory relief against ACCET and each of the entities that could enforce the loan, all appellees in this case: Bank of America, N.T. & S.A. (the current loan holder); California Student Loan Financing Corporation (a corporation that acquires student loans on the secondary market and which directed Bank of America to purchase Armstrong's loan as its trustee); the Secretary of Education (who assumed the guarantee of Armstrong's loan after the original guarantor became insolvent); and Educational Credit Management Corporation (a corporation created by the Department to manage loan guarantees assumed by the Secretary). Dismissing her federal claims, the district court held that no cause of action arises under the Department's school-origination policy or the FTC Rule. *See Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 832 F. Supp. 419, 432 (D.D.C. 1993) ("*Armstrong I*"). Armstrong now concedes this point. The district court also dismissed Armstrong's state law claims except her common law fraud and misrepresentation claims against ACCET. *See id.* at 425-26, 434.

On appeal, this court found that the district court, having dismissed the federal claims, failed to "expressly exercise its discretion to maintain or decline jurisdiction over the pendant claims under 28 U.S.C. § 1367." *Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 84 F.3d 1452

(D.C. Cir. 1996) (unpublished table decision), 1996 WL 250412, at *1. We remanded to the district court for further proceedings.Exercising its discretion, the district court again dismissed Armstrong's claims as to all defendants except ACCET (which subsequently settled with Armstrong and is no longer involved in these proceedings). *See Armstrong v. Accrediting Council for Continuing Educ. & Training, Inc.*, 980 F. Supp. 53 (D.D.C. 1997) ("*Armstrong II*"). The district court held that Armstrong had no claim under the District of Columbia CCPA because the choice of law clause made California law applicable. It rejected her argument that the so-called "public policy exception" in choice of law doctrine required D.C. courts to override the choice of law clause and to apply the District's more protective consumer protection statute instead. *See id.* at 59-60. As to Armstrong's mistake and illegality claims, the district court found that the school had not lost its GSLP eligibility until after she enrolled, and that at any rate federal Higher Education Act policy preempted state law defenses based on lack of school accreditation. *See id.* at 61-64.

Appealing again, Armstrong reasserts her state law claims, arguing: (1) that the Holder Rule notice should be implied into her loan contract; (2) that the school's loss of accreditation rendered it ineligible to participate in the GSLP program, making her loan unenforceable on grounds of mistake or illegality; and (3) that the district court should not have applied the choice of law clause because it conflicts with D.C. public policy enacted to protect District citizens. With respect to the last claim, Armstrong asks us alternatively to certify the choice of law question to the District of Columbia Court of Appeals. Our review is *de novo*. *See Systems Council EM-3 v. AT&T Corp.*, 159 F.3d 1376, 1378 (D.C. Cir. 1998).

II

We begin with Armstrong's implied contract claim. Relying on the FTC Holder Rule, she argues that National Business School had a "referral relationship" or "affiliation" with FITCO, thus permitting her to treat subsequent lenders as "standing in the shoes" of the school and to assert the school's misconduct as a defense against loan repayment. As the government acknowledged at oral argument, had Armstrong signed her loan contract after the 1992 amendments to the Higher Education Act, at which point the Secretary incorporated the Holder Rule notice into the common promissory note, she might well have a claim. Armstrong's allegation that the school gave her a loan application preprinted with FITCO's name as the chosen lender would support a Holder Rule notice claim because the school "*recommend[ed]* that the applicants seek loans" from FITCO, and FITCO either supplied the preprinted forms itself or "kn[e]w that a loan applicant was referred by [the] school." Overview, FTC Rule at 2, 3.

Acknowledging that her pre-1992 loan agreement contained no Holder Rule notice, Armstrong argues that the FTC's Holder Rule nevertheless required the notice's inclusion and that the court should therefore enforce it as an implied contractual term. She relies on the common law principle that contracts incorporate the law in force at the time of the agreement. *See United Van Lines, Inc. v. United States*, 448 F.2d 1190, 1195 (D.C. Cir. 1971) ("Because the regulation was in existence at the time [the party] entered on performance, it became, in effect, a part of the contract between the parties."); *see also Ballarini v. Schlage Lock Co.*, 226 P.2d 771, 773-74 (Cal. 1950) ("The settled law of the land at the time a contract is made becomes a part of it and must be read into it."). Appellees disagree. They argue that the FTC Holder Rule did

not apply to student loans made in 1988 and that even if it did, its terms cannot be implied into Armstrong's agreement.

We think appellees have the better of this argument. Although the Truth in Lending Act, the source of the Holder Rule, originally covered GSLP lending, Congress expressly exempted student loans from the Act in 1982. At that point the FTC stopped enforcing the Holder Rule with respect to GSLP loans. Not until after Armstrong obtained her loan from FITCO did the FTC again begin enforcing the Holder Rule in GSLP loans, and not until after that did the Secretary incorporate the notice into the common promissory note. *See supra* at 4, 5. Facing circumstances very much like those presented in this case, the Seventh Circuit, relying on the 1982 TILA Amendments, expressly held the Holder Rule inapplicable to guaranteed student loans obtained prior to renewal of Holder Rule enforcement. *See Veal v. First Am. Sav. Bank*, 914 F.2d 909, 914 (7th Cir. 1990).

To be sure, both the FTC and the Secretary have since suggested that the Holder Rule did in fact apply to guaranteed student loans during the period when Armstrong obtained her loan. *See* FTC Opinion at 2-3 (rejecting its previous "literal interpretation" exempting GSLP loans from the Holder Rule and claiming that Congress did not mean to exclude such loans from the Rule's coverage when it exempted them from TILA); Overview, FTC Rule at 1 (concluding that "the FTC Holder Rule notice must be included in the common application/promissory note."). In our view, however, these later developments are insufficient to overcome the clear implications of the 1982 TILA Amendments and the FTC's nonenforcement policy. Moreover, even if there were some ambiguity as to the Holder Rule's applicability to student loans during the late 1980s, we would not imply the terms of the notice into Armstrong's loan for one simple reason: No one

could reasonably argue that in 1988 appellees, the purchasers and assignees of Armstrong's note (which contained no Holder Rule notice), should have known that the Holder Rule nevertheless applied to GSLP loans at that time. Lenders still operated under a federal program that encouraged them to make loans for attendance at virtually any accredited school, no matter how deficient or disreputable. While Congress and the Department have since changed the rules, we think it would be unfair to apply the new rules to old loans.

Relying on contract-based theories of mistake and illegality, Armstrong next claims that her loan is void and unenforceable because National Business School had lost its accreditation in 1987 and was therefore not an institution "eligible" for participation in the federal student loan program. *See* 20 U.S.C. § 1085(a), (c) (1988). The district court rejected this claim, holding that schools do not lose their GSLP eligibility until after a hearing before an administrative law judge; in this case the hearing did not occur until 1989, a year after Armstrong received her loan. Armstrong now argues that the district court mistakenly relied on regulatory instead of statutory eligibility rules. She points out that under statutory rules, "the effective date of a loss of eligibility by reason of the failure of an institution, its location, or its program to satisfy the applicable definitions continues to be the date on which the failure first occurred." 55 Fed. Reg. 32,181 (1990) (Secretary's explanation of the effects of failure to meet statutory requirements). We need not resolve this dispute to decide this case, for regardless of when National Business School lost its GSLP eligibility, we agree with the Secretary that federal student loan policy preempts Armstrong's claims.

Federal preemption can be express or implied. *See Cippollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992). Nothing in the Higher Education Act expressly preempts state

law claims of the kind raised by Armstrong. Implied preemption occurs either "where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress 'left no room' for supplementary state regulation" (known as field preemption) or "in those areas where Congress has not completely displaced state regulation, ... to the extent [state law] actually conflicts with federal law" (known as conflict preemption). *California Fed. Sav. & Loan Ass'n v. Guerra*, 479 U.S. 272, 281 (1987) (internal quotation omitted). In *Jackson v. Culinary School*, we held that federal education policy regarding GSLP lending is not so extensive as to occupy the field. *See Jackson v. Culinary Sch.*, 27 F.3d 573, 580-81 (D.C. Cir. 1994), *vacated on other grounds*, 515 U.S. 1139, *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995). *Jackson* also recognized that the Higher Education Act preempts D.C. laws that "actually conflict" with federal law. *Id.* at 581 (stating but declining to reach the conflict preemption issue). Although *Jackson* was later vacated on other grounds, we believe that it correctly stated and applied federal preemption standards.

"Actual conflict" between Armstrong's contract claims and Higher Education Act regulations is precisely what has occurred here. If accepted, Armstrong's claim that she may void her student loan based on the school's alleged GSLP ineligibility would frustrate specific federal policies regarding the consequences of losing or falsely certifying accreditation. For example, it is the Secretary and guaranty agencies—not students—who enforce statutory and regulatory requirements, including those concerning accreditation and school misrepresentation. *See* 20 U.S.C. § 1094(c) (1988); 34 C.F.R. §§ 668.71-.75, 682.700-.710 (1988). Reinforcing this point, the preamble to the final rule regarding institutional eligibility says this:

> [The Department] considers the loss of institutional eligibility to affect directly only the liability of the institutionfor Federal subsidies and reinsurance paid on those loans.... [T]he borrower retains all the rights with respect to loan repayment that are contained in the terms of the loan agreements, and [the Department] does not suggest that these loans, whether held by the institution or the lender, are legally unenforceable merely because they were made after the effective date of the loss of institutional eligibility.

58 Fed. Reg. 13,337 (1993). Moreover, the Department expressly permits lenders to rely in good faith on eligibility representations by students and schools so long as the schools did not "originate" the loans. *See* 34 C.F.R. § 682.206(a)(2) (1988). Allowing mistake and illegality claims based on GSLP eligibility requirements to void student loan repayment obligations would "stand[ ] 'as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Guerra*, 479 U.S. at 281 (*quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

This brings us finally to Armstrong's claim under the District of Columbia Consumer Credit Protection Act. She relies on section 28-3809, which provides:

> (a) A lender who makes a direct installment loan for thepurpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller arising out of the purchase of the goods or service if such lender acts at the express request of the seller, and—
>
> > (1) the seller participates in the preparation of the loan instruments....

D.C. Code Ann. § 28-3809 (1981). Characterizing her guaranteed student loan as a "direct installment loan," Armstrong argues that National Business School's marketing of FITCO loans through preprinted application forms, along with its assistance in filling out loan applications, brings her loan within the CCPA's protection. According to appellees, the district court properly dismissed Armstrong's CCPA claim on the ground that the promissory note's choice of law clause made California law applicable. *See Armstrong II*, 980 F. Supp. at 58-60.

We need not determine whether D.C. courts would set aside the choice of law clause as contrary to D.C. public policy or whether, alternatively, to certify this question to the D.C. Court of Appeals, because we again agree with the Secretary that Armstrong's state law cause of action conflicts with pre-1992 federal policy governing guaranteed student loans. As we have noted, pre-1992 federal student loan policy was intended to make student loans attractive to private lenders by protecting them from the financial consequences of student default. Although the Department's school-origination policy certainly allows students to raise school misconduct defenses in limited circumstances, the Department expressly warned that the policy was "not intended to create any other rights for student borrowers or to suggest that borrowers are excused from repaying loans" except where there is a school-origination relationship. 58 Fed. Reg. 13,337 (1993). Allowing student borrowers to raise CCPA defenses based on school misconduct against lenders who do no more than permit schools to "participate[ ] in the preparation of the loan instruments" at the schools' "request," D.C. Code Ann. § 28-3809(a), would extend lender liability beyond school- origination relationships. In letter rulings discussing circumstances closely mirroring the facts of this case, the Secretary assured lenders that they do *not* risk falling within the scope of the school-origination policy

merely by "market[ing] GSL lending by sending combined application/promissory note/disclosure forms ... with the lender's name preprinted thereon, directly to the school," and allowing schools to assist students in completing loan applications on those forms. Letter from John E. Dean, Clohan & Dean, to Larry Oxendine, Director, Division of Policy and Program Development, U.S. Dep't of Educ. (Dec. 14, 1990); Letter from Larry Oxendine to John E. Dean (Feb. 20, 1991). Permitting Armstrong to raise CCPA defenses against repayment of her pre-1992, pre-common promissory note loan would subject appellees to risks neither anticipated by them nor intended by the Guaranteed Student Loan Program.

Nothing in *United States v. Griffin*, 707 F.2d 1477 (D.C. Cir. 1983), requires a different result. There, we found no preemption of state law defenses by a different student loan program under which the federal government insures GSLP loans made directly by schools. Because under that program the student borrowed directly from the school, the Department's school-origination policy squarely applied, and the asserted state law claims did not expand lender risk beyond that contemplated by federal policy. Moreover, allowing students to raise school misconduct defenses against the federal government could have had no impact on the private lending that Congress considered so critical to the operation of the pre-1992 Guaranteed Student Loan Program.

III

We acknowledge that denying relief to Armstrong may seem unfair. Lenders that permitted schools to abuse the Guaranteed Student Loan Program and that profited enormously prior to the 1992 changes are protected by federal preemption. Owners of schools that profited from student loans while failing to provide promised training and resources

are protected by bankruptcy laws. Only the students, the very people the Guaranteed Student Loan Program was intended to benefit, are left holding the bag.

The 1992 changes in the federal student loan program went a long way toward eliminating this unfairness for students who borrowed after 1992. The Secretary has even established loan discharge procedures for two categories of pre-1992 borrowers: those whose for-profit schools closed while they were in attendance, and those whose own GSLP eligibility (not the school's eligibility) was falsely certified. *See* 34 C.F.R. § 682.402(d), (e) (1997). These procedures provide no relief for students like Armstrong, whose schools falsely represented their accreditation or engaged in other misconduct. We have no authority to protect such students, but we think the Secretary does. *See* 20 U.S.C.A. §§ 1082(a), 1087-0 (Supp. 1998).

So ordered.

KAREN LECRAFT HENDERSON, *Circuit Judge*, concurring:

I concur in the result but neither agree with nor deem appropriate the concluding two paragraphs of the opinion. The student loan program may have its flaws but there is no basis to wring our hands over this one, especially when defaulting student loan borrowers constitute a significant national problem in the administration of the program.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued October 2, 1998 Decided March 23, 1999

No. 97-5316

Vanessa Armstrong,
Appellant

v.

Accrediting Council for Continuing Education and
Training, Inc., et al.,
Appellees

On Petition for Rehearing

Before: Henderson, Randolph and Tatel, *Circuit Judges.*

ORDER

On consideration of appellant's petition for rehearing, it is

Ordered by the court that the petition be denied and that the slip opinion filed herein on March 23, 1999 (reported at 168 F.3d 1362) be amended as follows:

On page 4 of the slip opinion (168 F.3d 1364-65), delete the first two sentences of the paragraph beginning "To further encourage ..." and replace them with the following:

Congress also excluded GSLP loans from the Truth in

> Lending Act ("TILA"), see Pub. L. No. 97-320, sec. 701(a), § 1603, 96 Stat. 1469, 1538 (1982), and the FTC stopped enforcing its so-called "Holder Rule" against GSLP lenders. See Federal Appellee's Br. at 25 ("1982 TILA amendments exempting student loans from TILA coverage convinced both courts and FTC staff that the Holder Rule thereafter no longer applied to GSLP loans."). Adopted by the FTC in 1976,....

On page 6 (168 F.3d 1365), in the first full sentence, replace the phrase stating "together with the FTC's renewed enforcement policy" with "together with the FTC's decision to enforce the Rule with respect to guaranteed student loans."

On page 10 (168 F.3d 1368), delete the two sentences following the sentence stating "We think appellees have the better of this argument" and replace them with the following:

> In 1982, Congress expressly exempted student loans from the Truth in Lending Act. At that point, because the Holder Rule incorporated TILA's definitions and was therefore considered limited to credit transactions covered by TILA, see 16 C.F.R. s 433.1(d), (e), the FTC stopped enforcing the Holder Rule with respect to GSLP loans. In a letter dated April 12, 1990, FTC staff, reiterating advice given in an earlier letter, described its "current enforcement position" as "[GSLP] loans would not be covered by the Holder Rule." Letter from John F. LeFevre, Program Advisor, Federal Trade Commission, to Joseph Esposito, Akin, Gump, Strauss, Hauer & Feld (Apr. 12, 1990). Although this advice was later "retracted," see Letter from John F. LeFevre to Joseph Esposito (June 20, 1990), that retraction related to future enforcement, and nothing in either it or elsewhere in the record contradicts the government's statement that the FTC stopped enforcing

the Holder Rule against GSLP lenders after the 1982 TILA Amendments. Not until after Armstrong obtained her loan....

On page 11 (168 F.3d 1368), replace the words "nonenforcement policy" in the second sentence of the full paragraph with "nonenforcement of the Holder Rule."

On page 14 (168 F.3d 1370), amend the last sentence on the page beginning "In letter rulings ..." to read: "In letter rulings discussing circumstances closely mirroring the facts of this case, *see Maljack Prods., Inc. v. Motion Picture Ass'n of America, Inc.*, 52 F.3d 373, 375 (D.C. Cir. 1995) (on motion to dismiss we accept the facts alleged in the complaint as true), the Secretary...." In addition, after the citation to "Letter from Larry Oxendine to John E. Dean (Feb. 20, 1991)" on page 15, add the following: "; see also 57 Fed. Reg. 60,304 ("The Secretary has also decided to describe an 'origination relationship' as a special business relationship between a school and a lender so as to distinguish it from the relationship that exists between these parties as part of the normal loan processing and delivery system.")."

Per Curiam

For the Court:
Mark J. Langer, Clerk
By: Deputy Clerk

Filed, September 30, 1997
[980 F. Supp. 53]

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No.: 91-3135 (RCL)

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR
CONTINUING EDUCATION &
TRAINING, INC., *et al.*,

Defendants.

MEMORANDUM OPINION

This matter comes before the court on remand from the Court of Appeals, *Armstrong v. Accrediting Council for Continuing Education and Training, Inc.*, 318 U.S. App. D.C. 78, 84 F.3d 1452 (D.C. Cir. 1996) (unpublished table decision), and on defendants' renewed motions to dismiss plaintiff's remaining claims pursuant to Fed. R. Civ. P. 12(b)(2) and (6). In the alternative, defendants seek summary judgment on these claims. For the reasons stated below, defendants Bank of America, California Student Loan Finance Corporation, Higher Education Assistance Foundation and the Secretary of Education's motions to dismiss are granted in full in accordance with this opinion.

I. BACKGROUND

A. Factual Background

As this motion comes before the court under Fed. R. Civ. P. 12(b)(2) and (6), defendants must prove that there is no set of facts upon which plaintiff is entitled to relief as a matter of law. *Conley v. Gibson*, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957) All allegations set forth in the complaint must be accepted as true and liberally construed in favor of plaintiff and all reasonable inferences must be drawn in favor of plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974). The complaint should be dismissed only if it appears beyond doubt that there is no set of facts proffered in support of plaintiff's claim that would entitle her to relief. *Conley*, 355 U.S. at 45-46; *Haynesworth v. Miller*, 261 U.S. App. D.C. 66, 820 F.2d 1245, 1254 (D.C. Cir. 1987).

Plaintiff Vanessa Armstrong enrolled in the Washington, D.C. campus of NBS Automotive School ("NBS"), a for-profit vocational school, in June 1988. At the time of her enrollment, NBS informed plaintiff that tuition for the program would exceed $ 5,000 but that the school could arrange a guaranteed student loan ("GSL") to pay most of the charges. According to plaintiff's amended complaint, NBS represented to her that its program was accredited by the Accrediting Council for Continuing Education and Training ("ACCET"), approved by the D.C. Educational Licensure Commission and certified by the Department of Education ("DOE" or "Department") as an "eligible institution" under the GSL program and the Higher Education Act of 1965, 20 U.S.C. §§ 1070 et seq. ("HEA"). Plaintiff Armstrong paid $ 1,317.91 directly to NBS, and NBS presented her with a loan application and promissory note for a GSL loan of $ 4,000, representing the balance of the tuition and fees.

According to the amended complaint, NBS "prepared the loan application and promissory note presented to plaintiff Armstrong, selected the lender and guarantee agency, specified the type of loan, determined the loan amount, made disclosures concerning the terms of the GSL loan, had plaintiff sign the promissory note, and disbursed the loan proceeds." Plaintiff's Amended Complaint at 8. The note provided that the loan was to be issued by First Independent Trust Company of California ("FITCO"), with the Higher Education Assistance Foundation ("HEAF") acting as guarantor. Plaintiff signed the application and the note on July 19, 1988. NBS certified that plaintiff met eligibility requirements for the loan, at which time FITCO and HEAF approved the loan and paid the proceeds to NBS.

Bank of America ("BA"), an eligible lender under 20 U.S.C. § 1085(d), subsequently purchased the plaintiff's GSL as trustee for the California Student Loan Finance Corporation ("CSLFC"), a corporation which acquires student loans under the HEA. BA is the current "holder" of the note. *See* 20 U.S.C. § 1085(i). FITCO, the original lender, was not named as a defendant in this action.

In or about December 1989, NBS closed its school in the District of Columbia. At the time of the filing of her amended complaint, plaintiff had made payments on her GSL loan of over $1,500. Over the ten year repayment period of the loan, the total of the monthly payments and interest is $7,565.76.

The gravamen of plaintiff's complaint is that she was defrauded by NBS, that the school was "a sham because it did not meet the standards for accreditation and failed to provide the educational training it promised," Plaintiff's Amended Complaint at 1-2, and that she should not be required to repay her creditors for an education she never received. She claims

that NBS was falsely accredited, and that she reasonably relied on NBS's representations concerning its program in deciding to enroll. Plaintiff initially filed a four-claim complaint, naming as defendants CSLFC, BA, HEAF, the Secretary of Education ("the Secretary") (as ultimate guarantor of all GSLs) and ACCET, the agency that granted accreditation to NBS, allowing the school to qualify for federal funds under the HEA. Plaintiff filed her amended complaint in October 1993 pursuant to this court's order in *Armstrong v. Accrediting Council for Continuing Education & Training, Inc.*, 832 F. Supp. 419, 435 (D.D.C. 1993) ("*Armstrong I*"), revising her claims against the Secretary and ACCET. Significantly, NBS has never been a party to this action.

B. Procedural History

In *Armstrong I*, this court held first that plaintiff could not assert a cause of action against defendants CSLFC/BA[1], HEAF, or the Secretary on common-law contract grounds of mistake or illegality.[2] *Armstrong I*, 832 F. Supp. at 426-27. Second, the

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[1] Because the relationship between Bank of America and the California Student Loan Finance Corporation make their interests identical and all motions have been filed jointly, they will hereinafter be referred to singularly as BA/CSLFC.

[2] *Armstrong I* also addressed claims against ACCET based on portions of the District of Columbia Consumer Protection Procedures Act, D.C. Code § 28-3904 (unfair trade practices) and common-law misrepresentation, with the former claim being dismissed. *Armstrong I*, 832 F. Supp. at 423-26. Cross-motions for summary judgment on the common-law misrepresentation claim were denied in *Armstrong v.*

court dismissed claims asserted under various sections of the D.C. Code, including §§ 28-3807, 3809 and 3813(f), concluding that although the HEA does not explicitly or implicitly preempt all state law, the particular statutory claims asserted by plaintiff were preempted because it was either impossible for an individual to abide by both the state law and the HEA, or enforcement of the D.C. statutory claims would preclude execution of the purposes and objectives of the HEA. *See id.* at 427-31. Third, the court dismissed both federal law and D.C. statutory/regulatory claims purportedly arising under the FTC Holder Rule, 16 C.F.R. § 433.2. *See id.* at 431-33. Finally, this court dismissed plaintiff's claims based on the existence of an "origination relationship" under 34 C.F.R. § 682.200 between the school and the initial lender against all defendants except the Secretary. *See id.* at 433-34.

On appeal, the D.C. Circuit vacated the above ruling and remanded the matter for further consideration. *Armstrong v. Accrediting Council for Continuing Education & Training, Inc.*, 318 U.S. App. D.C. 78, 84 F.3d 1452 (D.C. Cir. 1996) ("*Armstrong II*") (unpublished table decision). The Court of Appeals directed this court to consider first whether, in the absence of any remaining federal law claims, jurisdiction should be maintained under 28 U.S.C. § 1367(C)(3). After reviewing the written submissions and oral arguments of all parties, the court decided to exercise jurisdiction and reach the merits of plaintiff's case, and further determined that declaratory relief was appropriate as to the pendent state claims. *Armstrong v.*

Accrediting Council for Continuing Education & Training, Inc., 961 F. Supp. 305 (D.D.C. 1997) ("*Armstrong IV*"), and therefore need not be revisited in this opinion.

Accrediting Council for Continuing Education & Training, Inc., 950 F. Supp. 1 (D.D.C. 1996) ("*Armstrong III*").

Having decided to exercise its jurisdiction, this court must now consider the remaining questions presented to it by the Court of Appeals. Specifically, this court is called upon to: 1. determine applicable state law under contemporary choice of law principles; 2. consider whether that law is preempted by the federal Higher Education Act; and, 3. if the state law is not preempted, review the application of the relevant law to plaintiff's claims.

Second, the Secretary has now moved to dismiss the claims against him based upon an alleged "origination relationship" between NBS and FITCO. This court will address that question pursuant to the Secretary's and HEAF's Renewed Motion to Dismiss.

Finally, in plaintiff's amended complaint, her second claim for relief alleges a cause of action against the Secretary under 20 U.S.C. §§ 1087(c)(1),(5) which directs the Secretary to discharge a borrower's liability by repaying the amount owed on the loan on all GSLs received on or after January 1, 1986 and report such discharge to credit bureaus if the student's eligibility under the HEA was falsely certified by the institution or if the student was unable to complete the program due to closure of the institution. Plaintiff alleges that she has been injured by the failure of the Secretary to perform these statutory obligations, and asks for relief in the form of a declaratory judgment and a writ of mandamus compelling the Secretary to perform his duties.

II. CHOICE OF LAW

In her complaint, plaintiff asserted a number of causes of action under District of Columbia law, including, *inter alia*, D.C. Code §§ 28-3809(a)(1), 28-3904(a),(b),(e),(f),(r); 28-3807; and 16 D.C. Mun. Regs. § 1212.1. However, the Supplemental Loan for Students (SLS) Application/Promissory Note signed by plaintiff included the following provision:

> To the extent not governed by federal law, this note shall be governed by the laws of the jurisdiction where the lender is located.

The original lender, FITCO, was located in Sacramento, California; BA/CSLFC are also California based. If the contractual choice of law provision is held operative and binding, California law would govern this case, thereby rendering all of plaintiff's District of Columbia claims invalid, with the exception of her claims based upon common-law principles of mistake and illegality, which, as discussed below, have previously been considered and dismissed by this court. *See Armstrong I*, 832 F. Supp. at 426-27. Whether a choice of law clause in a student loan contract is enforceable is a matter of first impression in this jurisdiction.

A federal court is directed to apply the choice of law rules for the forum in which it sits. *See A.I. Trade Finance, Inc. v. Petra International Banking Corp.*, 314 U.S. App. D.C. 122, 62 F.3d 1454, 1463-64 (D.C. Cir. 1995) ("In other settings in which a federal court must rule upon an issue regulated only by state law, it applies the forum state's choice of law rules . . . ."). *See also Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487, 496, 85 L. Ed. 1477, 61 S. Ct. 1020 (1941) ("It is not for the federal courts to thwart such local policies by enforcing

an independent "general law" of conflict of laws."). Consequently, this court will apply choice of law doctrine from the District of Columbia.

Before addressing the applicability of the choice of law clause in the loan contract, there exists a threshold question as to which jurisdiction's law would apply absent the clause. To determine controlling law, the District of Columbia follows an "interest analysis" approach. The law governing the case is the law of the jurisdiction with the most "significant relationship" to the matter at issue. *Trout Unlimited v. United States Dep't of Agriculture*, 944 F. Supp. 13, 19 (D.D.C. 1996) (*citing Church of Scientology Int'l v. Eli Lilly & Co.*, 848 F. Supp. 1018, 1026 (D.D.C. 1994)); *see also Greycoat Hanover F. Street Limited Partnership v. Liberty Mutual Insurance Co.*, 657 A.2d 764, 767-68 (D.C. App. 1995) (noting that the fact that an incident occurred in D.C. is not independently sufficient to require the application of D.C. law). Plaintiff Armstrong is a Maryland resident and NBS is a Maryland corporation. The initial lender, FITCO, was a California corporation that made the loan from California. Plaintiff's loan payments were mailed to CSLFC in California; BA, the current holder of the note, is also located in California. Finally, the NBS branch plaintiff attended was located in the District of Columbia, and the loan that is the subject of this action was negotiated and signed by plaintiff at NBS' facilities in the District of Columbia. Consequently, any of one of three jurisdictions has a substantial nexus to this transaction, and an argument could be made under D.C.'s prevailing "interest analysis" choice of law doctrine that its law should apply.

As among these three options, this court holds that District of Columbia law would govern this action absent the choice of law clause from the loan contract. First, there is authority for the

proposition that when a consumer purchases goods and services in the District, the law of the District governs the contract. *McCrossin v. Hicks Chevrolet, Inc.*, 248 A.2d 917, 920-21 (D.C. App. 1969). Here, the purchase of the services -- the signing of the loan agreement -- occurred in D.C. In addition to being the place of contracting, D.C. was also the place of performance and the location of the subject matter of the contract, NBS. These factors tip the balance in favor of recognizing D.C. law as the relevant law but for the choice of law clause.

District of Columbia choice of law doctrine recognizes the ability of parties to select the operative law they wish to govern a transaction as part of their freedom of contract, provided that the jurisdiction selected has a "substantial relationship" to the parties or the transaction. *Norris v. Norris*, 419 A.2d 982, 984 (D.C. App. 1980). A recent enunciation of this "substantial relation" test, recognizing the validity of a choice of law clause, is found in *Ekstrom v. Value Health Inc.*, 314 U.S. App. D.C. 340, 68 F.3d 1391, 1394 (D.C. Cir. 1995), in which the court cited Norris and upheld the selection of Connecticut law on contracts and arbitrability because the surviving entity in a merger operated principally in Connecticut. *See also Gray v. American Express Co.*, 240 U.S. App. D.C. 10, 743 F.2d 10, 17 (D.C. Cir. 1984) (applying Maryland choice of law principles in upholding the contractual selection of New York law because one of the parties was a New York corporation and the choice bore some substantial relation to the parties or their transaction); *cf. Milanovich v. Costa Crociere*, 293 U.S. App. D.C. 332, 954 F.2d 763, 767 (D.C. Cir. 1992) (noting that under American law, choice of law provisions are usually honored); Restatement (Second) of Conflict of Laws § 187 (1971).

There is little question that California has a substantial

relation to the loan transaction at issue. FITCO, the initial lender, was a California based corporation (as are BA and CSLFC) located in Sacramento. The location of one of the two parties to the loan contract in California creates the critical nexus between the transaction and the jurisdiction indicated in the choice of law clause such that this court is compelled to apply that forum's law. *See Gray*, 743 F.2d at 17 (holding that because American Express was a New York corporation, there was a sufficient basis to defer to the clause calling for the application of New York law). Also contributing to California's "substantial relation" is the fact that the loan was approved by FITCO in California, and the plaintiff made her payments to CSLFC in California.

Plaintiff's opposition to the validity of the choice of law clause does not take issue with this application of the "substantial relation" test. Rather, she seeks to avoid the effects of the choice of law provision by claiming that the purpose of the clause was to frustrate the protections afforded by D.C.'s consumer protection laws. *See* Plaintiff's Opening Memorandum on Resolution of the Merits on Remand at 17 ("Plaintiff's Opening Memorandum"). It is a general principle of choice of law doctrine that if a party or parties stipulate to a given forum's law, that stipulation will not be given effect if it is included for the express purpose of evading otherwise applicable law or is contrary to either public policy or a statute enacted for the protection of that state's citizens. *See, e.g., Allen v. Lloyd's of London*, 94 F.3d 923, 928 (4th Cir. 1996) (outlining situations under which choice of law and choice of forum provisions may be found unreasonable); 16 Am. Jur. 2d Conflict of Laws § 78 (1979).

However, the GSL loan contract under consideration here does not present the type of situation in which courts typically

invalidate choice of law provisions. FITCO did not deliberately or willfully select California law with the nefarious purpose of avoiding the effect of District of Columbia consumer protection laws. Nor did FITCO endeavor to select a state with particularly relaxed consumer protection laws. The forum selection clause in question is boilerplate language which calls for the application of "the laws of the jurisdiction where the lender is located." It does not specify the selection of any one particular state. Under this clause, had the lender been a District of Columbia bank, the loan contract would have called for the application of District of Columbia law. Had the lender been a Texas bank, the choice of law clause would have directed this court to apply Texas law. In the instant case, because the lender was a California bank, the choice of law clause mandates the application of California law. It may very well be the case that California has a more generous body of consumer protection law than does the District of Columbia. The purpose of this clause had nothing to do with avoiding the District's laws or its public policies. It is both rational and reasonable for a lender to operate consistently under laws of its home state, rather than be forced to operate under 51 different laws depending upon the location of the "object of the loan contract," which is the result that plaintiff's argument would compel.

Furthermore, this is not a case, as plaintiff characterizes it, where a lender seeks to "evade these statutes by making his own laws applicable." Plaintiff's Opening Memorandum at 17 (*citing* A. Ehrenzweig, A Treatise on Conflict of Laws § 204, at 523 (1962)). The choice of law clause was not inserted by FITCO. FITCO was utilizing HEAF's standard form promissory note, as it was required to do by law. The note in question, with its boilerplate choice of law clause, was approved by DOE for use throughout the United States. *See* 34 C.F.R. § 682.401(d)(1)(1990) ("The guaranty agency shall submit to the

Secretary its application forms, promissory notes and write-off criteria and procedures. The agency shall not use these materials until the Secretary approves them."). This is hardly the paradigmatic situation in which lenders are trying to "frustrate statutes designed to regulate their conduct." Plaintiff's Opening Memorandum at 18. Rather, FITCO was using the loan form that federal law directed it to use, and was therefore compelled to accept both the benefits and the burdens of the law of the jurisdiction in which it was located -- California. Plaintiff must similarly accept the benefits and burdens of California law.

This conclusion, though never expressly reached in this jurisdiction, was hinted at by the D.C. Circuit in *Jackson v. Culinary School of Washington, Ltd.*, 307 U.S. App. D.C. 123, 27 F.3d 573 (D.C. Cir. 1994) ("*Jackson II*"). In addressing the question as to whether students could utilize the District of Columbia's consumer protection laws to assert defenses against their lenders, the Court of Appeals, in declining to resolve HEA preemption issues, wrote, "we find ourselves unable to say with confidence that D.C. law will apply in any future coercive action brought by the declaratory judgment defendants." 27 F.3d at 581. In a footnote, the court continued, "To the extent the record points any direction on choice of law, it points against appellants, because several of the loan instruments in the case contain express choice of law provisions identifying other states' laws as providing the operative rules of decision." *Id.* at 581 n.14.

Because California has a substantial relation to the transaction, and because the choice of law clause was not inserted with the express purpose of evading otherwise applicable local consumer protection laws, this court will give effect to the choice of law clause in the loan contract. Consequently, to the extent that state law governs this case,

California law applies. This court is therefore compelled to dismiss all of plaintiff's claims arising under the both the D.C. Code and D.C. municipal regulations. This conclusion does not, however, leave plaintiff without any state or local law causes of action: she is, of course, entitled to whatever protections may be available under California law, and may seek leave to refile yet another amended [3]

III. PREEMPTION

The Court of Appeals next directs this court to determine whether the applicable state law is preempted by the Higher Education Act. Because the plaintiff has not asserted any statutory claims under California law, a full exegesis on this question is not possible, as one cannot determine whether compliance with state law is either "impossible" or "precludes execution of the purposes and objectives of the HEA." *Armstrong I*, 832 F. Supp. at 429.

Under *California Federal Savings and Loan Ass'n v. Guerra*, 479 U.S. 272, 280-81, 93 L. Ed. 2d 613, 107 S. Ct. 683 (1987), preemption occurs if: (1) Congress has expressly declared that state law is preempted; (2) a Congressional intent to "occupy the field" can be inferred because the scheme of regulation is so comprehensive as to preclude the application of state law; (3) state law conflicts with federal law such that

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[3] The fact that plaintiff may elect to assert claims under California law does not necessarily mean that she is entitled to the remedies she seeks. She would still need to prove that her state law claims are not preempted by the HEA, and overcome whatever other hurdles California law presents in stating a claim upon which relief may be granted.

compliance with both is either a physical impossibility, or the state law would stand as an obstacle to the accomplishment of the purposes and objectives of the federal law.

In *Armstrong I*, this court concluded that the HEA neither explicitly nor implicitly preempts all of state law. *Armstrong I*, 832 F. Supp. at 428 (citing *Tipton v. Secretary of Education*, 768 F. Supp. 540 (S.D. W. Va. 1991); *see also Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1244-46 (D.D.C. 1992) ("*Jackson I*")). Subsequent decisions have reaffirmed this conclusion. *See, e.g., Keams v. Tempe Technical Institute, Inc.*, 39 F.3d 222, 225 (9th Cir. 1994) (holding that the HEA does not expressly preempt state common law tort claims against accreditors); *Crawford v. American Institute of Professional Careers, Inc.*, 934 F. Supp. 335, 339 (D. Ariz. 1996). Therefore, possible pre-emption of state law by the HEA is a consideration only in cases in which it is either impossible for an individual to abide by both state law and the HEA, or where state law precludes execution of the purposes and objectives of the HEA. *See Armstrong I*, 832 F. Supp. 419 at 429; *Keams*, 39 F.3d at 226-27; *Crawford*, 934 F. Supp. at 339-41.

At this juncture, this court's review of whether the appropriate statutory law is preempted must come to its end, as the court is not currently presented with any California statutory law with which to undertake the necessary analysis. This court will review the pre-emption questions as directed by the Court of Appeals if plaintiff elects to amend her complaint by alleging violations of California consumer protection laws.

IV. PLAINTIFF'S CLAIMS BASED UPON MISTAKE AND ILLEGALITY

California does recognize the common-law doctrines of mistake and illegality. See Cal. Civ. Code § 1576-78 (mistake), 1598-99 (illegality) (West 1982). Therefore, these two claims survive this court's determination that California law applies to the loan agreement.

As plaintiff states in her Opening Memorandum, "there is no need to choose between District of Columbia and California law with respect to plaintiff's claims based on common law principles, because there is no conflict between the potentially applicable state laws on these common law issues." Plaintiff's Opening Memorandum at 16. Because there is little difference between the District of Columbia and California on these common-law causes of action, the court's analysis from *Armstrong I* will be applied to these claims on remand. Consequently, this court will again dismiss plaintiff's claims based upon mistake and illegality.

The essence of plaintiff's mistake and illegality claims against CSLFC/BA, HEAF and the Secretary is that NBS did not meet the requirements for an "eligible institution" as defined under 20 U.S.C. § 1085(a) at the time plaintiff received her GSL because NBS's accreditation had expired on May 31, 1987. *See* 28 U.S.C. § 1085(c)(4) (addressing accreditation of vocational schools). As either an illegal contract, or one based on mistake, it would be voidable by plaintiff. Plaintiff grounds her claim in the language of 34 C.F.R. § 600.40(a)(1)(i), which states that an institution loses its eligibility on the date that it fails to meet any of the Department's eligibility requirements. Plaintiff alleges that it is the June 1, 1987 date on which the school first failed to satisfy the financial responsibility requirements of 34 C.F.R. §

668.13 that should be determinative, and, because her enrollment post-dated that time, the contract is voidable.

In *Armstrong I*, this court held that plaintiff misconstrued the manner in which an institution loses its eligibility, explaining that, under 34 C.F.R. § 668, a school's loss of eligibility cannot precede requisite procedural due process, including notification of the offending school, a hearing before an administrative law judge and even a possible appeal to the Secretary. *Armstrong I*, 832 F. Supp. 419 at 426. Additionally, 34 C.F.R. § 668.94 ("Termination") provides only for prospective changes, proscribing future acts by the institution such as making new obligations, or making further guarantee commitments. The retroactive effect prayed for by plaintiffs was held to be contrary to the plain language of the regulation. *Armstrong I*, 832 F. Supp. at 426-27.

Even if this court could be convinced that it had erred on the question of retroactivity, plaintiff would still be unable to advance her illegality or mistake claims as a matter of law. The Department of Education has issued a definitive statement as to whether student loans may retroactively become invalid upon a school's loss of accredited status:

> ED [the Department] considers the loss of institutional eligibility to affect directly only the liability of the institution for Federal subsidies and reinsurance paid on these loans. In either case, the borrower retains all the rights with respect to loan repayment that are contained in the terms of the loan agreements, and ED does not suggest that these loans, whether held by the institution or the lender, are legally unenforceable merely because they were made after the effective date of the loss of institutional eligibility.

58 Fed. Reg. 13,337 (1993). The concept of retroactivity under 34 C.F.R. 600.40(a) is a matter that impacts only the relationship between the school and DOE, not the school and the student, nor the student and DOE. "The regulations [34 C.F.R. §§ 600.40(a), 668.94(b)] are not intended to create any other rights for student borrowers or to suggest that borrowers are excused from repaying loans received to attend that institution." 58 Fed. Reg. 13,337 (1993). If NBS was in fact accredited at the time plaintiff Armstrong entered into her loan contract -- and both sides concede that it was -- then the inquiry as to whether plaintiff's ıoan contract was based upon mistake or illegality comes to its end. For purposes of determining the validity of plaintiff's loan, the court is directed to take a snapshot of the world as it existed at time of plaintiff's enrollment, and, in this case, the school was accredited by ACCET. If that accreditation was improvidently granted, that is a matter of concern between the school and DOE, not between plaintiff and the lenders and guarantors she has named as defendants.

Plaintiff's request that this court again consider its holding on procedural due process in light of *Beth Rochel Seminary v. Bennett*, 263 U.S. App. D.C. 341, 825 F.2d 478 (D.C. Cir. 1987) does not significantly advance her argument. In *Beth Rochel*, DOE sought to recover financial aid funds improperly received by Beth Rochel Seminary because the Department determined that the school did not qualify for participation in the federal program. The Court of Appeals held "the regulation provides that a right to notice and hearing 'does not apply to a determination that . . . an institution of higher education fails to meet the statutory definition set forth in section [] . . . 1201 of the Higher Education Act.' 34 C.F.R. § 668.-71(c)(1)(1986)." 825 F.2d at 481. Even if plaintiff's claim that procedural due process is not required to retroactively terminate accredited status, Beth Rochel still only addresses a school's responsibility

to make restitution to DOE of funds received. Plaintiff's logical leap from Beth Rochel that, "likewise, under the doctrines of mistake and illegality, NBS's failure to satisfy this essential condition of the loan contracts makes plaintiff's contractual obligations void and unenforceable" is simply too great. Plaintiff's Opening Memorandum at 32. The fact that the school in Beth Rochel had to make restitution to the Department does not ipso facto prove that defendants here must make restitution to plaintiff, especially in light of the DOE's statement from the Federal Register set out above. The rights of DOE against a school is not neatly analogous to the rights of students against third party lenders and guarantee agencies, as the regulatory structure and case law make clear.

Having dismissed the mistake and illegality claims on the above grounds in *Armstrong I*,[4] this court originally declined to address defendant's claim that the HEA preempts these common-law defenses. The court did state in a footnote, "Should the court have analyzed the issue, it would have determined that allowing plaintiff to raise these defenses certainly would have such a deleterious effect on the GSL program, as discussed in Part IV.B., below, that the court would have found it necessary to preempt these claims." *Armstrong I*, 832 F. Supp. at 427 n.17. As the Court of Appeals has specifically directed the court to consider the extent to which state law is preempted by the HEA, this court will now address this issue.

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[4] This court also dismissed plaintiff's claims based upon mistake and illegality because allocation of the risk of mistake on BA/CSLFC, HEAF and the Secretary was "unwarranted and unjust." As nothing from the Court of Appeals' opinion affects this analysis, there is no need to revisit this territory.

The HEA expressly vests the Secretary of Education with exclusive authority to determine the existence, scope and duration of a school's eligibility under HEA programs. 20 U.S.C. § 1099c(a). While the Secretary has the authority to decide whether a particular accreditor's standards warrant approval as a reliable indicator of educational quality, 20 U.S.C. § 1099b(a), the Department itself is barred from interfering in an accrediting agency's assessment regarding individual schools. 20 U.S.C. § 3403(b). This structure for determining whether a school is an "eligible institution" for GSL purposes -- involving a carefully-crafted balance between the role of the Secretary and the role of the accreditor -- has been affirmatively established by Congress. Were this court to allow plaintiff to proceed on her mistake and illegality claims, this court would be placed in the position of having to determine if, at the time of the signing of the loan contract, eligibility requirements were met despite the fact that NBS was accredited by ACCET. For plaintiff to prevail, this court would have to substitute its judgment for ACCET's and conclude that accreditation was improperly granted. To place the court in this role would be contrary to clear Congressional intent. The courts would become the ultimate arbiters of eligibility, called upon to make fact-based determinations that are best made by experts in the field -- professional accreditors. Because state law claims based upon mistake and illegality would require the courts to enter the educational evaluation business, and Congress has by statute provided that the Secretary via accrediting agencies are to make these determinations, the state law claims conflict with the federal claim, and are thereby preempted.[5]

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[5] This preemption analysis may affect plaintiff's open claim against ACCET. Because one of the elements of common-law fraud is proof of a false representation, *Blake Construction*

Plaintiff's common-law claims must also be dismissed on preemption grounds because the purposes of the HEA would be frustrated if plaintiff's state law claims of mistake and illegality were allowed to go forward merely because the school should not have been accredited at the time of her matriculation. *See Guerra*, 479 U.S. at 281. In fact, the effects could be devastating. Upon graduation and receipt of a diploma from an otherwise meritorious institution, a student could review the school's financial data at the time of enrollment, seize upon a technical violation of the accreditation rules, and assert a claim that her loan contract was thereby illegal or mistaken.

For example, under 20 U.S.C. § 1099c(c)(2) & 34 C.F.R. § 668.15, a school must maintain prescribed asset-to-liability ratios, operating fund deficits, and the like. Under plaintiff's theory of mistake and illegality, a student could avoid subsequent loan payments if that student could successfully demonstrate to a court of law that the ratio fell below prescribed levels (or the operating deficit rose too high) at the time the student's loans were executed even if the deficiency was not detected at the time by an accrediting agency. Or, theoretically, a student could try to proceed with a claim of supervening illegality if a school's accreditation requirements were not

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Co. v. C.J. Coakley, Co., 431 A.2d 569, 577, this court or a jury may find itself in the position of having to determine whether the school did not meet the requisite accreditation standards during the period of automatic extensions. This would be the exact form of second-guessing that a court is to avoid. Conversely, because proof of fraud also requires "knowledge of falsity," preemption may not be an issue; preemption may not eliminate state law causes of action based on intentional or reckless deceitful acts.

maintained at any time during the student's enrollment period. This potential result is all the more troubling because many of the statutory and regulatory criteria governing schools have only a tangential relationship to educational quality from the perspective of the student. For example, there are requirements proscribing a school from having more than 50% of its students enrolled in correspondence courses, or more than 50% of an admissions class composed of students who lack high school diplomas or the recognized equivalent. 20 U.S.C. §§ 1088(a)(3)(B) & (a)(3)(D). Accreditation requirements, while developed for the overall benefit of students, are, at their core, a matter between the institution and the DOE and usually are related more to finances than pedagogy. The possibility of students avoiding their loan obligations through canvassing for accreditation violations cautions against creating a private right of action under the HEA, and, in the same vein, disallowing the same private enforcement through the "back door" route of common-law causes of action.

Were such claims to go forward, it would surely be followed quickly by the exit of many lenders from the GSL program. Banks and guaranty agencies would likely be far less generous if they knew their obligations could be cut off via technical violations of accreditation requirements. This result would "preclude the execution and purposes and objectives of the HEA," which is to make funds widely available for students who otherwise cannot afford the opportunities higher education promises. *See* 20 U.S.C. § 1070(a) ("It is the purpose of this part, to assist in making available the benefits of postsecondary education to eligible students in institutions of higher education"); 1980 U.S. Code Cong. & Admin. News p. 3168; 1976 U.S. Code Cong. & Admin. News p. 4731 (recognizing the "massive contribution to financing post-secondary educational opportunities made in the ten years of the operation

of the GSLP"). There is a reason why Congress has elected to not create a private right of action under the HEA, and this court refuses to disturb that rationale. To the extent that a resort to state law claims would seriously frustrate Congress' goal of making loans widely available to students while at the same time making participation in this program attractive to lenders, such state law claims must be deemed as preempted. *Accord, Morgan v. Markerdowne Corp.*, 976 F. Supp. 301, 1997 U.S. Dist. LEXIS 13665, at 46 (D.N.J. 1997).

For the above reasons, plaintiff's state law claims based on the doctrines of mistake and illegality against BA/CSLFC, HEAF and the Secretary must be dismissed.

V. PLAINTIFF'S ORIGINATION CLAIM AGAINST THE SECRETARY

Having addressed the specific issues posed by the Court of Appeals, this court will note that plaintiff's claims for relief against BA/CSLFC and HEAF -- all of which were dismissed in *Armstrong I* -- are wholly unaffected by the resolution of the choice of law or preemption questions. Nonetheless, both plaintiff and defendants have dedicated substantial portions of their briefs on remand to issues that were definitively resolved in 1993, most notably claims arising under the FTC Holder Rule.

In *Armstrong I* this court concluded, consistent with the weight of authority, that the FTC Holder Rule, 16 C.F.R. § 433.2, affords plaintiff with no basis for asserting claims and defenses against defendants because the requisite notice was not part of the loan contract. And, even if the Holder Rule's notice was implied into the contract, there would still be no power to grant relief because violations of the Holder Rule do not furnish

private parties with a cause of action. *See Armstrong I*, 832 F. Supp. at 431-33 (citing *Holloway v. Bristol-Myers Corp.*, 158 U.S. App. D.C. 207, 485 F.2d 986 (D.C. Cir. 1973)). Subsequent decisions have only reinforced this court's resolution of that question. *See Bartels v. Alabama Commercial College*, 918 F. Supp. 1565, 1570 (S.D. Ga. 1995) ("Even assuming that the FTC Holder Rule applies to student loan transactions, a plaintiff has no rights under the rule if the notice is omitted from the contract. Furthermore, there is no private cause of action under the FTC Holder Rule. . . . enforcement of the rule is the sole province of the Federal Trade Commission.") (citations omitted); *Markerdowne*, at 25. ("Notwithstanding the conclusion that the FTC Holder Rule was applicable to plaintiff's student loans, the parties agree that violation of the rule does not give rise to a federal private cause of action.").

Furthermore, plaintiff's "origination" claims allegedly arising under 34 C.F.R. § 682.200 against third-party defendants BA/CSLFC and HEAF and do not need to be reanalyzed in light of the Court of Appeals' vacating and remanding of the earlier judgment. The Secretary's "unofficial policy" of not enforcing loans which are the product of an origination relationship is not binding on third parties, *see Armstrong I*, 832 F. Supp. at 433-34, and plaintiff therefore cannot assert claims and defenses against these parties, even if such a relationship could be proven. Again, subsequent holdings of other courts have buttressed this court's determination that the Secretary's policy of forbearing enforcement of loans when an origination relationship exists cannot be used against lenders and guaranty agencies such as (BA/CSLFC and HEAF) because the APA's rulemaking procedures were not followed in creating the "policy." *See Bartels*, 918 F. Supp. at 1570; *Williams v. National Sch. of Health Tech.*, 836 F. Supp. 273, 284-85 (E.D. Pa. 1993) ("Although an agency may choose to bind itself in an informal

matter, it cannot regulate third parties other than by utilizing the mechanisms of the APA established for that purpose.") (citation omitted).

Consequently, the only origination claim remaining is against the Secretary. In Armstrong I, the Secretary did not move to dismiss plaintiff's claims based on an alleged origination relationship. *See Armstrong I*, 832 F. Supp. at 433-34. In his Renewed Motion to Dismiss, the Secretary now seeks to dismiss the origination claims. As the D.C. Circuit has now affirmatively determined that a student does not have a cause of action against the Secretary based on the Secretary's non-enforcement "policy," this court will grant the Secretary's motion to dismiss.[6]

Under 34 C.F.R. § 682.200, an "origination relationship" is a relationship between a school and a lender in which the lender delegates to the school "substantial functions" in the execution of the loan that are normally performed by the lender. Specifically, this "origination relationship" exists where:

> (1) A School determines who will receive a loan and the amount of the loan;
>
> (2) The lender has the school verify the identify of the borrower or complete forms normally completed by the lender.

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[6] Claims based on the alleged origination relationship between FITCO and NBS against the Secretary were dismissed without prejudice by this court's Order of July 25, 1997. Because this order was vacated by the Court of Appeals in *Armstrong II*, this court will again address this claim.

In cases in which an origination relationship exists, the Secretary has a long-standing policy of abstaining from collection. *See, e.g.*, 55 Fed. Reg. 48,327 (1990); Letter from Kenneth D. Whitehead, Acting Assistant Secretary of Education, to Stephen J. Solarz, House of Representatives (May 19, 1988). Plaintiff now wishes to convert this policy into a federal cause of action against the Secretary.

In *Jackson v. Culinary School of Washington, Ltd.*, 307 U.S. App. D.C. 123, 27 F.3d 573 (D.C. Cir. 1994) ("Jackson II"), fifty-nine former students sought declaratory and injunctive relief against various lenders, guarantee agencies and the Secretary for the actions of the defunct and judgement-proof Culinary School of Washington. Included in plaintiffs' complaint was a claim against the Secretary based upon an alleged origination relationship. The threshold issue considered by the Court of Appeals was as to whether there was a "federally grounded right to enforce the Secretary's alleged promise [to abstain from collections]." 27 F.3d at 583.

In *Jackson II*, the Department conceded its longstanding policy to refrain from enforcing student loans in cases where the lenders and schools were in an origination relationship. *Id.* at 585 (citing *Armstrong I*, 832 F. Supp. at 433-35). The court noted that, in determining whether an agency's "promise" is enforceable by third parties, the relevant inquiry is agency intent. *See* 27 F.3d at 584 (citing *National Latino Media Coalition v. FCC*, 259 U.S. App. D.C. 481, 816 F.2d 785, 788 n.2 (D.C. Cir. 1987) ("the 'binding' quality of a particular rule or statement will depend on whether the agency intended to establish a 'substantive' rule . . . ."). *Quoting Vietnam Veterans v. Secretary of the Navy*, 269 U.S. App. D.C. 35, 843 F.2d 528, 537 (D.C. Cir. 1988), the Court of Appeals next stated, "statements whose language, context and application suggest an

intent to bind agency discretion and private party conduct -- the sort of statements requiring compliance with [APA] § 553 -- will have that effect if valid; interpretive rules or policy statements will not, regardless of their validity.'" *Id.*

As to whether the Secretary's "rule" was meant to create substantive rights in third parties, the court first cited the Secretary's position - as described in *Armstrong I* -- that "where there is an origination relationship between the school and the lender, the student's claims and defenses as to the school can be asserted as defenses to the loan contract . . . ." *Jackson II*, 27 F.3d at 585. However, on the other side of the balance, the court noted that there had been a proposed regulation on borrower defenses that would have codified the Secretary's policy, 55 Fed. Reg. 48,327 (1990), but this proposal was never adopted by DOE, and, in fact, was explicitly rejected. See 57 Fed. Reg. 60,304 (1992) ("the Secretary has decided that it is not desirable at this time to prescribe in regulations a uniform Federal rule regarding borrower defenses that would preempt State law otherwise applicable to FFEL [GSL] programs").[7]

Balancing the arguments in favor of and against creating a substantive cause of action based upon an alleged origination relationship, the Jackson II court concluded, "the Secretary has

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[7] This discussion in the Federal Register does identify "four kinds of State laws whose application would not frustrate FFEL program policies and are therefore not preempted by federal law." However, since plaintiff has not pleaded any claims under California law, this court's analysis must presently end upon determining that there is no federal claim against the Secretary based upon an origination relationship.

not sufficiently communicated an intention to be bound by his origination policy so as to create a legally enforceable right grounded in federal law." *Jackson II*, 27 F.3d at 585. Additionally, the court opined:

> The paltry fragments suggesting the Department's intent, the amorphous language and unrelated context of the letters, and, finally, the Department's indication in 1992 that it preferred continuation of the regime of state defenses to the promulgation of a uniform federal rule all suggest to us the manifest impropriety of deeming the origination-forbearance policy enforceable by appellants as a matter of federal law.

Id. Other jurisdictions have subsequently been in accord with *Jackson II*'s conclusion that there is no federal cause of action against the Secretary based upon an alleged origination relationship. In *Bartels*, 918 F. Supp. at 1572, the court considered whether the Secretary's informal policy could be used as a defense to a loan obligation. That court, in accord with *Jackson II*, held, "The Secretary's policy was that the Department of Education would refrain from trying to enforce unenforceable loans, not that an origination relationship creates a private cause of action for breach of contract." *Id.* at 1573. Similarly, in *Williams*, 836 F. Supp. at 285, the court concluded that the Secretary's policy does not afford plaintiff relief against the Secretary. "The Secretary has not indicated that the Department of Education would actively discharge loans based on the existence of an origination relationship but merely that the Secretary would not seek to enforce such loans."

Consistent with this Circuit's holding in *Jackson II*, and the weight of authority from other jurisdictions, plaintiff's federal claim against the Secretary based upon an origination

relationship must be dismissed.

VI. PLAINTIFF'S CLAIM AGAINST THE SECRETARY TO PERFORM ITS STATUTORY DUTY PURSUANT TO 20 U.S.C. § 1087(c)(1)

In *Armstrong I*, this court took note of the seemingly curious fact that this suit persisted despite Congress's passage of 20 U.S.C. § 1087(c). This statute reads:

> If a borrower who received, on or after January 1, 1986, a loan made, insured, or guaranteed under this part and the student borrower, or the student on whose behalf a parent borrowed, in unable to complete the program in which such student is enrolled due to the closure of the institution or if such student's eligibility to borrow under this part was falsely certified by the eligible institution, then the Secretary shall discharge the borrower's liability on the loan (including interest and collection fees) by repaying the amount owed on the loan and shall subsequently pursue any claim available to such borrower against the institution and its affiliates and principals or settle the loan obligation pursuant to the financial responsibility authority under subpart 3 of part G.

Plaintiff now, in her amended complaint, asserts that the Secretary has failed to perform his duty under this statute by not discharging the loans and by failing to notify local credit bureaus of such a discharge. Plaintiff asks this court to enter a declaratory judgment and issue a writ of mandamus compelling

the Secretary to act in accordance with § 1087(c)(1).[8]

While plaintiff has identified her proper source of relief due to the school's failure to deliver on the education it promised, she has not pursued the proper means for obtaining such relief. Section 1087(c)(1), while enacted for the benefit of students whose schools close prior to the student's completion of the course of study, does not create a private cause of action. *Bega v. United States Department of Education*, 180 B.R. 642 (Bankr. D. Kan. 1995) (determining that 20 U.S.C. § 1087(c) does not present an alternative means for a bankruptcy court to discharge student loan obligations when other means of discharge are not available).

The proper mechanism for obtaining discharge of a loan obligation when a student's school closes is administrative -- as per 34 C.F.R. § 685.213(c). This regulation requires a borrower to submit to the Secretary a "written and sworn statement" attesting that the student received the proceeds of the loan and that the student did not complete the program due to closure of the school. The student must also list other claims asserted with respect to the school's closure, and agree to cooperate with and provide information to the Secretary.

At least one federal court has reached an identical conclusion as to whether a private right of action could be implied under 20 U.S.C. § 1087(c)(1) in an action similar to the instant case. In Williams, the court concluded:

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[8] This claim was initially dismissed as per this court's order of July 25, 1995, but, pursuant to the Court of Appeals' vacating of this order in *Armstrong II*, this court will now address this claim in greater detail.

> It is uncontested that the loan discharge provisions were enacted for the benefit of students such as the plaintiff. That conclusion alone, however, is not sufficient to imply a right of action to enforce the provisions. Where a statute provides an administrative enforcement mechanism, it is presumed that Congress did not mean to create a private right of action.

836 F. Supp. at 279 (cited in *Bega*, 180 B.R. at 643.) *Cf. Touche Ross v. Redington*, 442 U.S. 560, 61 L. Ed. 2d 82, 99 S. Ct. 2479 (1979) (holding that federal courts should only create private rights of action when there exists affirmative evidence of Congressional intent to do so).

As plaintiff's amended complaint demonstrates no evidence that she has availed herself of her administrative remedies as outlined above, this court cannot and will not perform the duty that Congress has expressly delegated to the Secretary -- the discharge of student loans under 20 U.S.C. § 1087.

VII. CONCLUSION

In their briefing of the issues on remand, plaintiff and defendants conflict over whether this case centers around creating a cause of action against third party lenders and guarantors for "educational malpractice." While this court does not agree with all of defendants' assertions that plaintiff is, through this suit, attempting to assert such a claim, it is undeniable that plaintiff is trying to obtain rescission of her loan agreement based upon her dissatisfaction with the quality of the education she received. As this court concluded in *Armstrong I*, if there was any wrongdoing in this case, it was the wrongdoing of NBS, as NBS is the only party who owed a duty of care to plaintiff as to receiving a promised education in the field of

automotive repair. The defendants in this case -- BA/CSLFC, HEAF and the Secretary -- have acted entirely in accord with the mandates of law.

In the absence of the Guaranteed Student Loan program, the opportunities available through higher education would be beyond the reach of many, if not most, students who seek the chance to better their station in life. To subject lenders to suit based on acts of the educational institutions would surely lead lenders to cease their participation in student loan programs. Most, if not all, courts who have considered the types of claims raised by plaintiff against "the usual suspects", have been vigilant in protecting the GSL and other student loan programs. This court will not depart from the path it took three years ago, and has been taken by almost all of those who have embarked upon this long journey.

Accordingly, the motions to dismiss will be granted in full.

A separate order shall issue this date.

Royce C. Lamberth
United States District Court

Filed Sept 30 1997

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA
C.A. No. 91-3135 RCL

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION & TRAINING, INC., *et al.*,

Defendants.

ORDER

This case comes before the court on the renewed motions to dismiss of defendants Bank of America, California Student Loan Finance Corporation, Higher Education Assistance Foundation and the Secretary of Education. Upon consideration of the filings of counsel and the relevant law, and for the reasons stated in the accompanying Memorandum Opinion, it is hereby ORDERED that:

1. The motion to dismiss filed by defendants Secretary of Education and Higher Education Assistance Foundation of January 28, 1997 is GRANTED; the second, third and fourth claims for relief are DISMISSED as to the HIGHER EDUCATION ASSISTANCE FOUNDATION and the SECRETARY. The second amended, third amended and fourth amended claims for relief are DISMISSED as to the

SECRETARY.

2. The motion to dismiss filed by defendants Bank of America and California Student Loan Finance Corporation of January 27, 1997 is GRANTED; the second, third, and fourth claims for relief are DISMISSED as to these defendants.

3. Defendant California Student Loan Finance Corporation's motion for protective order is DENIED AS MOOT.

4. Plaintiff's motion to compel production of documents is DENIED AS MOOT.

5. Plaintiff's motion to substitute the Educational Credit Management Corporation as defendant is GRANTED and the Educational Credit Management Corporation shall hereafter be substituted for the Higher Education Assistance Foundation as defendant herein.

6. A status call on plaintiff's and class claims against the Accrediting Council for Continuing Education & Training, Inc. is scheduled for 4:30 p.m. on Wednesday, October 15, 1997.

SO ORDERED.

Royce C. Lamberth
United States District Court
Date: 9-30-97

Filed Oct 31, 1997

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

C.A. No. 91-3135 RCL

VANESSA ARMSTRONG,

Plaintiff,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION & TRAINING, INC., *et al.*,

Defendants.

ORDER

Upon consideration of Plaintiff's Motion to Amend Judgment and Motion for Entry of Final Judgment Pursuant to Fed. R. Civ. P. 54(b), and the response thereto, the Court finds that the Memorandum Opinion and Order of September 30, 1997 should be amended as described below, and that there is no just reason for delay entering final judgment dismissing plaintiff's claims against defendants Secretary of Education, Bank of America NT&SA, California Student Loan Finance Corporation, and Higher Education Assistance Foundation and Transitional Guaranty Agency. The claims against these defendants are separable from the fraud claim that remains to be adjudicated against the Accrediting Council for Continuing Education and Training, and this Court's decision to dismiss these claims rests on purely legal issues that can be presented to

the Court of Appeals without interfering with the litigation of the remaining claim in this Court. Moreover, there is a danger of hardship if appeal is delayed until the remaining claims are finally adjudicated because of the penalties and sanctions imposed for failure to repay contested student loans. Defendants will not be prejudiced by entry of a final judgment. Thus, both judicial administrative interests and the equities involved favor entry of a final judgment. Therefore, it is hereby, this ____ day of _____, 1997,

ORDERED that plaintiff's motion to amend is granted; and it is further

ORDERED that Section VI of the Court's Memorandum Opinion of September 30, 1997 is hereby withdrawn and the last sentence of paragraph 1 of the Court's Order of September 30, 1997 is amended to read: "The third amended and fourth amended claims for relief are dismissed as to the SECRETARY."; and it is further

ORDERED that the second sentence of footnote 7 of the Court's Memorandum Opinion of September 30, 1997 is hereby amended to read: "However, since plaintiff has not pleaded any claims under California statutory law, this court's analysis must presently end upon determining that there is no *federal* claim against the Secretary based upon an origination relationship."; and it is further

ORDERED that the Clerk is directed to enter final judgment dismissing the Second, Third, and Fourth Claims for Relief in plaintiff's complaint of December 10, 1991, because this Court determines that there is no just reason for delay in entering final judgment with respect to this Court's decision of September 30, 1997, because the claims that the Court has

dismissed as a matter of law are separable from the claims that remain to be adjudicated in this action, and there is a danger of hardship if appeal is delayed until the remaining claims are finally adjudicated.

_____ 10/30/97

Royce C. Lamberth
United States District Court Judge

Truth in Lending Act

15 USC § 1603 Exempted transactions

(as amended by Pub. L. 97-320, title VII, § 701(a), Oct. 15, 1982, 96 Stat.1538)

This subchapter does not apply to the following:

* * *

(7) Loans made, insured, or guaranteed pursuant to a program authorized by title IV of the Higher Education Act of 1965 (20 U.S.C. 1070 et seq., 42 U.S.C. 2751 et seq.).

Higher Education Act of 1965

20 U.S.C. § 1077. Eligibility of student borrowers and terms of federally insured student loans (1988)

(a) *List of requirements.* Except as provided in section 1078-3, a loan by an eligible lender shall be insurable by the Secretary under the provisions of this part only if--

(1) made to a student who (A) is an eligible student under section 1091, (B) has agreed to notify promptly the holder of the loan concerning any change of address, and (C) is carrying at least one-half the normal full-time academic workload for the course of study the student is pursuing (as determined by the institution); and

(2) evidenced by a note or other written agreement which--

(A) is made without security and without endorsement;

(B) provides for repayment (except as provided in subsection (c)) of the principal amount of the loan in installments over a period of not less than 5 years (unless sooner repaid or unless the student, during the 6 months preceding the start of the repayment period, specifically requests that repayment be made over a shorter period) nor more than 10 years beginning 6 months after the month in which the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, except--

(i) as provided in subparagraph (C);

(ii) that the note or other written instrument may contain such reasonable provisions relating to repayment in the event of default in the payment of interest or in the payment of the cost of insurance premiums, or other default by the borrower, as may be authorized by regulations of the Secretary in effect at the time the loan is made; and

(iii) that the lender and the student, after the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, may agree to a repayment schedule which begins earlier, or is of shorter duration, than required by this subparagraph, but in the event a borrower has requested and obtained a repayment period of less than 5 years, the borrower may at any time prior to the total repayment of the loan, have the repayment period extended so that the total repayment period is not less than 5 years; (C) provides that periodic installments of principal need not be paid, but

interest shall accrue and be paid, during any period--

(i) during which the borrower--

(I) is pursuing at least a half-time course of study as determined by an eligible institution; or

(II) is pursuing a course of study pursuant to a graduate fellowship program approved by the Secretary, or pursuant to a rehabilitation training program for individuals with disabilities approved by the Secretary, except that no borrower shall be eligible for a deferment under this clause, or a loan made under this part (other than a loan made under 1078-2 or 1078-3), while serving in a medical internship or residency program;

(ii) not in excess of 3 years during which the borrower is seeking and unable to find full-time employment; or

(iii) not in excess of 3 years for any reason which the lender determines, in accordance with regulations prescribed by the Secretary under section 1085(o), has caused or will cause the borrower to have an economic hardship;
and provides that any such period shall not be included in determining the 10-year period described in subparagraph (B);

(D) provides for interest on the unpaid principal balance of the loan at a yearly rate, not exceeding the applicable maximum rate prescribed in section 1077a, which interest shall be payable in installments over the period of the loan except that, if provided in the note or other written agreement, any interest payable by the student may be deferred until not later than the date upon which repayment of the first installment of principal falls due, in which case interest accrued during that period may be added on that date to the principal;

(E) provides that the lender will not collect or attempt to collect from the borrower any portion of the interest on the note which is payable by the Secretary under this part and that the lender will enter into such agreements with the Secretary as may be necessary for the purpose of section 1087;

(F) entitles the student borrower to accelerate without penalty repayment of the whole or any part of the loan;

(G) (i) contains a notice of the system, of disclosure of information concerning such loan to credit bureau organizations under section 1080a, and (ii) provides that the lender on request of the borrower will provide information on the repayment status of the note to such organizations;

(H) provides that, no more than 6 months prior to the date on which the borrower's first payment on a loan is due, the lender shall offer the borrower the option of repaying the loan in accordance with a graduated or income-sensitive repayment schedule established by the lender and in accordance with the regulations of the Secretary; and

(I) contains such other terms and conditions, consistent with the provisions of this part and with the regulations issued by the Secretary pursuant to this part, as may be agreed upon by the parties to such loan, including, if agreed upon, a provision requiring the borrower to pay the lender, in addition to principal and interest, amounts equal to the insurance premiums payable by the lender to the Secretary with respect to such loan;

(3) the funds borrowed by a student are disbursed to the institution by check or other means that is payable to and requires the endorsement or other certification by such student, except--

(A) that nothing in this title shall be interpreted--

(i) to allow the Secretary to require checks to be made copayable to the institution and the borrower; or (ii) to prohibit the disbursement of loan proceeds by means other than by check; and

(B) in the case of any student who is studying outside the United States in a program of study abroad that is approved for credit by the home institution at which such student is enrolled, the funds shall, at the request of the borrower, be delivered directly to the student and the checks may be endorsed, and fund transfers authorized, pursuant to an authorized power-of-attorney; and

(4) the funds borrowed by a student are disbursed in accordance with section 1078-7.

(b) *Special rules for multiple disbursement.* For the purpose of subsection (a)(4)--

(1) all loans issued for the same period of enrollment shall be considered as a single loan; and

(2) the requirements of such subsection shall not apply in the case of a loan made under section 1078-2 or 1078-3, or made to a student to cover the cost of attendance at an eligible institution outside the United States.

(c) *Special repayment rules.* Except as provided in subsection (a)(2)(H), the total of the payments by a borrower during any year of any repayment period with respect to the aggregate amount of all loans to that borrower which are insured under this part shall not, unless the borrower and the lender otherwise agree, be less than $ 600 or the balance of all such loans (together with interest thereon), whichever amount is less (but in no instance less than the amount of interest due and payable).

(d) *Borrower Information.* The lender shall obtain the borrower's driver's license number, if any, at the time of application for the loan.

20 U.S.C. § 1078. Federal payments to reduce student interest costs (1988)

(a) **Federal interest subsidies.**

(1) *Types of loans that qualify.* Each student who has received a loan for study at an eligible institution--

(A) which is insured by the Secretary under this part; or

(B) which is insured under a program of a State or of a nonprofit private institution or organization which was contracted for, and paid to the student, within the period specified in paragraph (5), and which--

(i) in the case of a loan insured prior to July 1, 1967, was made by an eligible lender and is insured under a program which meets the requirements of subparagraph (E) of subsection (b)(1) and provides that repayment of such loan shall be in installments beginning not earlier than 60 days after the student ceases to pursue a course of study (as described in subparagraph (D) of subsection (b)(1)) at an eligible institution, or

(ii) in the case of a loan insured after June 30, 1967, was made by an eligible lender and is insured under a program covered by an agreement made pursuant to subsection (b), shall be entitled to have paid on his or her behalf and for his or her account to the holder of the loan a portion of the interest on such loan under circumstances described in paragraph (2).

(2) *Additional requirements to receive subsidy.*

(A) Each student qualifying for a portion of an interest payment under paragraph (1) shall--

(i) have provided to the lender a statement from the eligible institution, at which the student has been accepted for enrollment, or at which the student is in attendance, which--

(I) sets forth such student's estimated cost of attendance (as determined under section 472;

(II) sets forth such student's estimated financial assistance; and

(III) sets forth a schedule for disbursement of the proceeds of the loan in installments, consistent with the requirements of section 1078-7;

(ii) meet the requirements of subparagraph (B); and

(iii) have provided to the lender at the time of application for a loan made, insured, or guaranteed under this part, the student's driver's number, if any.

(B) For the purpose of clause (ii) of subparagraph (A), a student shall qualify for a portion of an interest payment under paragraph (1) if the eligible institution has provided the lender with a statement evidencing a determination of need for a loan (as determined under part F of this title) and the amount of such need, subject to the provisions of subparagraph (D).

(C) For the purpose of paragraph (1) and this paragraph--

(i) a student's estimated financial assistance means, for the period for which the loan is sought, the amount of assistance such student will receive under subpart 1 of part A (as determined in accordance with section 484(b), subpart 3 of part A, and parts C and E of this title, and any veterans' education benefits paid because of enrollment in a postsecondary education institution, including veterans' education benefits (as defined in section 1087vv(c)), plus other scholarship, grant, or loan assistance.

(ii) the determination of need and of the amount of a loan by an eligible institution under subparagraph (B) with respect to a student shall be calculated in accordance with part E.

(D) An eligible institution may not, in carrying out the provisions of subparagraphs (A) and (B) of this paragraph, provide a statement which certifies the eligibility of any student to receive any loan under this part in excess of the maximum amount applicable to such loan.

(E) For the purpose of subparagraphs (B) and (C) of this paragraph, any loan obtained by a student under section 1078-1 or a parent under section 1078-2 or under any State-sponsored or private loan program for an academic year for which the determination is made may be used to offset the expected family contribution of the student for that year.

(F) Except as provided in subparagraph (D), an eligible institution may refuse to certify a statement which permits a student to receive a loan under this part or to certify a loan amount that is less than the student's determination of need (as determined under part E of this title), if the reason for such action is documented and provided in written form to each student so affected.

* * *

District of Columbia Consumer Credit Protection Act
D.C. Code § 28-3809. Lender subject to defenses arising from sales.

(a) A lender who makes a direct installment loan for the purpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller arising out of the purchase of the goods or service if such lender acts at the express request of the seller, and --

(1) the seller participates in the preparation of the loan instruments, or

(2) the lender is a person or organization controlled by or under common control with the seller, or

(3) the seller receives or will receive a fee, compensation, or other consideration from the lender for arranging the loan.

(b) The lender's liability under this section may not exceed the amount of the loan. Rights of the debtor can only be asserted affirmatively in an action to cancel and void the sale from its inception, or as a matter of defense to or set-off against a claim by the lender.

Federal Trade Commission Regulations on Preservation of Consumers Claims and Defenses, 16 C.F.R. § 433

16 C.F.R. § 433.1 Definitions.

(a) *Person.* An individual, corporation, or any other business organization.

(b) *Consumer.* A natural person who seeks or acquires goods or services for personal, family, or household use.

(c) *Creditor.* A person who, in the ordinary course of business, lends purchase money or finances the sale of goods or services to consumers on a deferred payment basis; Provided, such person is not acting, for the purposes of a particular transaction, in the capacity of a credit card issuer.

(d) *Purchase money loan.* A cash advance which is received by a consumer in return for a "Finance Charge" within the meaning of the Truth in Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement.

(e) *Financing a sale.* Extending credit to a consumer in connection with a "Credit Sale" within the meaning of the Truth in Lending Act and Regulation Z.

(f) *Contract.* Any oral or written agreement, formal or informal, between a creditor and a seller, which contemplates or provides for cooperative or concerted activity in connection with the sale of goods or services to consumers or the financing thereof.

(g) *Business arrangement.* Any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

(h) *Credit card issuer.* A person who extends to cardholders the right to use a credit card in connection with purchases of goods or services.

(i) *Consumer credit contract.* Any instrument which evidences or embodies a debt arising from a "Purchase Money Loan" transaction or a "financed sale" as defined in paragraphs (d) and (e) of this section.

(j) *Seller.* A person who, in the ordinary course of business, sells or leases goods or services to consumers.

16 C.F.R. 433.2 Preservation of consumers' claims and defenses, unfair or deceptive acts or practices.

In connection with any sale or lease of goods or services to consumers, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it is an unfair or deceptive act or practice within the meaning of section 5 of that Act for a seller, directly or indirectly, to:

(a) Take or receive a consumer credit contract which fails to contain the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD

ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

or,

(b) Accept, as full or partial payment for such sale or lease, the proceeds of any purchase money loan (as purchase money loan is defined herein), unless any consumer credit contract made in connection with such purchase money loan contains the following provision in at least ten point, bold face, type:

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Department of Education
Guaranteed Student Loan Program Regulations

(adopted, 51 Fed Reg. 40889 (Nov. 10, 1986);
superseded, 57 Fed Reg. 60279 (Dec. 18, 1992))

34 C.F.R. § 682.200 Definitions

(b) The following definitions also apply to this part:

* * *

Origination: A special relationship between a school and a lender, in which the lender delegates to the school, or to an entity or individual affiliated with the school, substantial functions or responsibilities normally performed by lenders before making loans. In this situation, the school is considered to have "originated' a loan made by the lender. The Secretary determines that "origination' exists if, for example --

(1) A school determines who will receive a loan and the amount of the loan; and

(2) The lender has the school verify the identity of the borrower or complete forms normally completed by the lender.

34 C.F.R. § 682.206(a) Due diligence in making a loan.

(a) *General.*

(1) The loan-making process includes processing the loan application and other required forms, approving the borrower for a loan, determining the loan amount, explaining to the borrower his or her responsibilities under the loan, completing and having the borrower sign the promissory note, and disbursing the loan proceeds.

(2) Except as may be authorized by the Secretary, a lender may not delegate its loan-making functions to a school unless the school has an origination relationship with the lender. If that relationship exists, the lender may rely in good faith upon statements of the borrower contained in the loan application, but may not rely upon statements made by the school in the application. A non-school lender that does not have an origination relationship may rely in good faith upon statements of both the borrower and the school that are contained in the application. Except as provided in Part 668, Subpart E, a school lender may rely in good faith upon statements made by the borrower in the loan application.

(b) *Processing forms.* Before disbursing a loan, a lender must determine that all required forms have been accurately completed by the borrower, the student, the school, and the lender. A lender may not ask the borrower to sign any loan form before all the information requested from the borrower on that form has been supplied.

(c) *Approval of borrower and determination of loan amount.*

(1) A lender may make a loan only to an eligible borrower. To the extent authorized by paragraph (a)(2) of this section, the lender may determine the borrower's eligibility based on the information provided on the application by the school, the borrower, and, if the borrower is a parent, the student on whose behalf the loan is sought.

(2) In determining the amount of the loan to be made, within the limitations of § 682.204, the lender shall review the data on the student's cost of attendance and estimated financial assistance that is provided on the application form. In no case may the loan amount exceed the student's estimated cost of attendance, less estimated financial

assistance, for the academic period for which the loan is intended.

(d) *Promissory note.*

(1) The lender shall obtain from the borrower an executed legally enforceable promissory note for each loan as proof of the borrowers' indebtedness.

(2) A lender may not add any clauses to, or modify any provisions of, the most current promissory note provided by the guarantor without the guarantor's prior approval.

(3) The lender shall give the borrower a copy of each executed note.

(e) *Security, endorsement, and comakers.*

(1) A FISLP or Federal PLUS Program loan shall be made without security or endorsement.

(2) A Federal PLUS Program loan may be made to two eligible parents who agree to be jointly liable for repayment of the loan as co-makers.

(f) *Loan disbursement.* A lender shall disburse funds as required by § 682.207.

DEPARTMENT OF HEALTH, EDUCATION,
AND WELFARE
OFFICE OF EDUCATION
WASHINGTON, DC 20302

June 28, 1996

TO ALL LENDERS AND EDUCATIONAL INSTITUTIONS

SUBJECT: Federal Trade Commission Trade Regulation Concerning Preservation of Consumers' Claims and Defenses

The Federal Trade Commission (FTC) published a Trade Regulation Rule in the *Federal Register* of November 18, 1975 (40 FR 53506) concerning the Preservation of Consumers' Claims and Defenses. The Rule became effective May 14, 1976.

In adopting this rule, the Federal Trade Commission determined that it constitutes an unfair and deceptive practice within the meaning of Section 5 of the Federal Trade Commission Act (15 U.S.C. 45) for a seller, in the course of financing a consumer purchase of goods or services, to employ procedures which make the consumer's duty to pay independent of the seller's duty to fulfill his obligations.

Effect of the Rule

The Rule is designed to insure that consumer credit contracts used in financing the retail purchase of consumer goods or services specifically preserve the consumers' claim and defenses. To achieve this result, it requires a seller to include a prescribed notice in the text of any consumer credit contract which it executes with a buyer. In addition, if a seller arranges

loan financing for his customers from a third party creditor, the Rule prohibits the seller from accepting the proceeds of the loan as payment for the sale, unless the loan contract signed by the buyer contains the prescribed notice.

Applicability of the Rule to the Guaranteed Student Loan Program

In order to determine to what extent this Rule affects the Guaranteed Student Loan Program, the Office of Guaranteed Student Loans has communicated with the staff attorneys of the Federal Trade Commission responsible for drafting the Rule. This bulletin provides preliminary guidance to participants in the Guaranteed Student Loan Program and has been reviewed by these attorneys.

The Rule is applicable to "sellers" when they finance or arrange financing for the sale of consumer goods and services. It appears that all for-profit educational institutions fall within the Rule's definition of "seller" and *are covered*. It appears that the Rule *does not* apply to public institutions.

A question arises, however, with respect to private non-profit institutions. The Rule, by its terms, would cover such institutions, but it does not appear that they fall within the FTC's jurisdiction. In addition, the FTC has not attempted to exercise jurisdiction over non-profit educational institutions that are genuinely not for profit.

For those institutions which are "sellers" under the Rule, the Rule requires inclusion of a notice (set out below) in the loan contract if the institution itself finances the sale of its services. This means that those school lenders within the Rule's coverage are required to include the notice in their student loan notes.

The Rule is also applicable to any covered school which:

(1) "refers" students to a "creditor," or

(2) is affiliated with the creditor by common control, contract, or business arrangement

In these situations, the school is forbidden to accept the proceeds of the loan unless the lender has included the required notice in the loan contract. The definitions of "business arrangement" and "creditor" are set out below.

The FTC's *Staff Guidelines* on the Rule discuss what is meant by referral in this context as follows:

> The word "refers" is intended to reach those situations where a seller, in the ordinary course of the ordinary course of business, is sending his buyers to a particular loan outlet, or to particular outlets, for credit which is to be used in the seller's establishment...
>
> No specific number of referrals is specified in the Rule. The key distinction is between those instances where a seller is merely passing along information about places where his buyers may obtain credit and those where a seller is acting as a conduit for financing and channeling buyer-borrowers to a particular lender or limited group of lenders...
>
> Finally, the test is whether the seller *routinely* [emphasis added] refers his customers to a lender or lenders. It is not whether a particular buyer was referred. This means that once a seller is referring his customers to a lender, all loan contracts between that lender and borrowers from that lender must contain the

> Notice...Conversely, it means that an occasional referral which is not part of a business routine of the seller does not trigger the Rule.

Selected Definitions from the Rule:

Business arrangement: Any understanding, procedure, course of dealing, or arrangement, formal or informal, between a creditor and a seller, in connection with the sale of goods or services to consumers or the financing thereof.

Creditor: A person who, in the ordinary course of business, lends purchase money or finances the sale of goods or services to consumers on a deferred payment basis; *Provided*, such person is not acting, for the purposes of a particular transaction, in the capacity of a credit card issuer.
(Note: it appears that a State agency is not included within this definition.)

Person: An individual, corporation, or any other business organization.

Seller: A person who, in the ordinary course of business, sells or leases goods or services to consumers.

Required Notice When Seller Provides Credit:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

Required Notice When Creditor Provides Credit as a Result of Business Arrangement Between Seller and Creditor:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

K.A. Kohl
Associate Commissioner
Office of Guaranteed Student Loans

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

January 9, 1989

Joseph Esposito, Esquire
Heron, Burchette, Ruckert, and Rothwell
1025 Thomas Jefferson Street, N.W.
Washington, D.C. 20007

Dear Mr. Esposito:

Please find enclosed the materials you requested respecting the Federal Trade Commission's Trade Regulation Rule concerning Preservation of Consumer Claims and Defenses ("Holder Rule"), 16 C.F.R. Part 433.

After considering your question about the applicability of the Holder Rule to loans for vocational education, I have reached the conclusion that such loans are typically not subject to the Holder Rule. The Holder Rule is limited in its application to credit transactions as defined in the Truth in Lending Act and Regulation Z. Regulation Z exempts from its coverage many student loan programs. 15 U.S.C. § 266.2 (f). Whether the student loan program with which your client is connected is subject to this exemption, however, is not fully determinable from the facts you have provided.

If you have additional questions on this matter, please do not hesitate to contact me.

Sincerely,
Richard C. Sauer, Attorney
Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

April 12, 1990

Joseph Esposito, Esquire
Akin, Gump, Strauss, Hauer & Feld
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Esposito:

In order to expedite our reply to your recent inquiry concerning the "Holder Rule," Mr. Keller referred your letter to me.

You ask about the applicability of the "Holder Rule," 16 C.F.R. Part 433, to loans for vocational education. As Mr. Sauer indicated in his letter of January 9, the Rule applies only to credit transactions as defined in the Truth in Lending Act and Regulation Z. Regulation Z exempts from its coverage student loans for vocational education *including* those provided under the Guaranteed Student Loan Program, Part B of Title IV of the 1965 Higher Education Act. Therefore, it is the Commission staff's opinion that such loans would not be covered by the Holder Rule.

Please be advised that this is merely the opinion of the Commission staff and is not binding on the Commission. However, it does represent staff's current enforcement position.

Sincerely,
John F. LeFevre
Program Advisor, General Credit Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

June 20, 1990

Joseph Esposito, Esquire
Akin, Gump, Strauss, Hauer & Feld
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Esposito:

This is in reference to my letter to you of April 12, 1990, and Mr. Sauer's letter to you of January 9, 1989, concerning the applicability of the Holder Rule to loans for vocational education. In those letters, we indicated that the Holder Rule would not apply to such loans because Regulation Z of the Truth in Lending Act (TILA) exempts such loans from its coverage, including loans authorized under the Guaranteed Student Loan Program, Part B of Title IV of the 1965 Higher Education Act.

In attempting to provide you with an expedited opinion on this issue, I relied heavily on the underlying premise of Mr. Sauer's letter, namely, that the Holder Rule should be limited in its application to credit transactions that are currently covered by the Truth in Lending Act and Regulation Z. Since I now have reason to believe that this premise may be incorrect, I must retract my letter to you of April 12 until Commission staff has had a chance to thoroughly research the issue.

My doubt stems from the realization that Mr. Sauer's premise was apparently based on several statements in the Commission's Statement of Basis and Purpose (SBP) for the

Rule (approved in 1975) indicating that Holder Rule coverage should be linked to TILA coverage. At that time, however, guaranteed student loans were covered by the TILA; in fact they were not exempted until 1982. This, coupled with the Commission's statement on page 53524 of the SBP (16 CFR 433) that the "[t]he rule expressly applies to credit contracts arising from sales or services, such as trade or vocational school agreements....," appears to indicate that the Commission at that time may have intended the loans at issue to be covered by the Holder Rule.

In any event, it is clear to me that further study is needed before a definitive opinion can be rendered. If we conclude that such loans are covered, it is my intention to recommend that the Commission issue an advisory opinion to that effect. In the meantime I would suggest that your client include the Holder notice in its loan agreements until the Commission acts.

I appreciate your cooperation in this matter and hope that this has not caused inconvenience to you or your client.

Sincerely,
John F. LeFevre
Program Advisor General Credit
Division of Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

July 24, 1991

Jonathan Sheldon, Esquire
National Consumer Law Center
11 Beacon Street - #821
Boston, Massachusetts 02108

Re: Application of Holder Rule to Federally Guaranteed Student Loans

Dear Mr. Sheldon:

This letter responds to your request, made in a filing in connection with the review by the Federal Trade Commission ("Commission") of its Trade Regulation Rule concerning Preservation of Consumers' Claims and Defenses (16 C.F.R. Part 433, the "Rule" or "Holder Rule") pursuant to the Regulatory Flexibility Act. You request a staff opinion letter clarifying the Rule's application to federally guaranteed student loans. For the reasons stated herein, it is the opinion of the FTC staff that federally guaranteed student loans are not exempt from the Rule.

1. *The Commission included educational loans when it promulgated the Rule in 1975.*

The literal scope of the Rule shows no hint of any exception for contracts entered for educational purposes. Under its provisions, a specific clause preserving consumer defenses is to be included in any "consumer credit contract" or "purchase money loan contract" by the seller "(i)n connection

with *any sale* or lease *of* goods or *services to consumers*" within the coverage of the FTC Act. 16 C.F.R. § 433.2 (emphasis added).[1]

The Statement of Basis and Purpose ("SBP") that the Commission issued when it promulgated the Rule, combined with the broad scope of the Rule, leaves no doubt that the Commission intended the Rule to cover for-profit[2] educational loans. 40 Fed. Reg. 53506 (November 18, 1975). In the SBP, immediately after quoting the required contractual language, the Commission stated:

> "The rule expressly applies to credit contracts arising from sales of services, *such as trade or vocational school agreements*..."(emphasis added) *Id.* at 53524.

Similarly, the Commission stated unequivocally that the record in the rulemaking proceeding pursuant to which the Rule was issued was replete with cases of instructional courses where fraud and deception had occurred:

> *"Courses of training or instructions*
>
> ...
>
> (C)ases brought to our attention include courses of

---

[1] As you know, if the particular consumer was not referred to the lender, and the lender was not affiliated with or otherwise had no business arrangement with the school, the transaction was not covered by the Rule. 15 C.F.R.. § 433.l(d).

[2] Of course, not-for-profit schools would not be covered, because they are beyond the regulatory authority of the Commission under the Federal Trade Commission Act. 15 U.S.C. § 44.

English language instruction, television and modeling school courses, computer schools, flying lessons, a karate school, and other miscellaneous courses of training or instructions." *Id.* at 53510.

Finally, the federal government's Office of Education had no doubt that the Holder Rule applied, stating in a release issued shortly after the Rule became effective that "all for-profit educational institutions fall within the Rule's definition of 'seller' and are covered" by its provisions and therefore "the school is forbidden to accept the proceeds of the loan unless the lender has included the required notice in the contract."[3]

2. *Congress did not exclude educational loans from coverage under the Rule when it amended the Truth in Lending Act in 1982.*

The only argument that educational loans are not covered focuses on a sequence of events that in no way relates to the substance of the Holder Rule. First, in 1975 when it formulated the key definitions of "purchase money loan" and "financing a sale" and promulgated the Rule, the Commission made reference to the Truth in Lending Act ("TILA") and its implementing Regulation Z.[4] Second, in 1982 Congress

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[3] Bulletin #L16/S9 dated June 28, 1976, directed "TO ALL LENDERS AND EDUCATIONAL INSTITUTIONS" by the Office of Education (Department of Health, Education and Welfare), predecessor to the Department of Education.

[4] [16 CFR §433.l(d-e)]. The former involves a "Finance Charge within the meaning of the TILA. . ." and the latter amounts to a "credit sale within the meaning of the TILA." The definition of "consumer credit contract" [16 CFR §433.1(i)],

amended the TILA to exclude federally guaranteed student loans from that law's coverage in order to avoid imposing on lenders duplicate disclosures that were required on federally guaranteed loans under the Higher Education Act of 1965.[5]

Although a literal interpretation might lead to the conclusion that federally guaranteed student loans became exempt from the Rule as a result of these actions,[6] the

---

the document which of course must include the required clause to preserve consumer defenses, incorporates by reference the "purchase money loan" and "financing a sale" definitions.

[5] TILA §104(5), 16 U.S.C. §1603(6), added by Section 701(a) of the Garn-St. Germain Depository Institutions Act of 1982.

[6] The Commission's staff guidelines issued in 1976 assumed that the Rule's adoption of TILA definitions meant that the Commission intended the scope of the Rule to equal that of the TILA. 41 Fed. Reg. 20022 (May 4, 1976). Your submission makes an argument that defining "purchase money loan" to be a cash advance that includes a "finance charge within the meaning of the TILA" means only that a loan is covered if it provides a finance charge that meets the criteria set forth in the statute and regulation [TILA §106, Reg. Z §226.4], and that the Guidelines were therefore wrong to equate the scope of the Rule with the TILA, even as it existed in 1976. Because we base our analysis on the Rule and principles of statutory construction, the Guidelines are not germane to our conclusion. In any event, it is clear that the Guidelines (like the Rule) contemplated the scope of the TILA as it existed in 1975 (or perhaps 1976, in the case of the Guidelines).

universally accepted rule of statutory interpretation that is applicable to this situation demonstrates that the 1982 amendment to the TILA had no impact on the Rule's scope.

The general rule for interpreting a statute that incorporates another statute is that the statute incorporated is taken as it existed at the time of incorporation, without subsequent amendments, unless the legislature has expressly or by strong implication shown its intention to incorporate subsequent amendments. Sutherland, Statutory Construction §51.08 (4th Ed. 1984); *Curtis Ambulance of Florida, Inc. v. Board of County Comm'rs, Shawnee County*, 811 F.2d 1371, 1378-79 (10th Cir. 1987). Stated more generally, if Statute A incorporates Statute B, a subsequent amendment to Statute B is disregarded in construing Statute A unless the legislature clearly intended to affect Statute A as well.[7] A similar interpretation should apply to regulations that incorporate statutes.

Furthermore, the Commission made it clear when the Guidelines were released that they did not change the Rule, stating, "The Commission wishes to call attention to the fact that (the Guidelines) have not been formally reviewed or adopted by the Commission, *nor does anything therein alter or amend either the Rule or the official Statement of Basis and Purpose published with the Rule."* (emphasis added) 41 Fed. Reg. 20022 (May 4, 1976).

[7] This same approach, of course, means that the 1976 Staff Guidelines, insofar as they indicate that the scope of the TILA is the same as the Rule, should be interpreted by using the TILA *as it existed when the Rule was promulgated* (or, with the same result, shortly afterward when the Guidelines were issued) as the frame of reference.

Applying the principle, it is clear to us that the Holder Rule's reference to the TILA and Regulation Z incorporated those laws only as they existed in 1975. In this case, there is no indication that the Commission intended to incorporate changes in the TILA, or that one of Congress' purposes in enacting the 1982 amendment to the TILA was to remove student loans from coverage by the Holder Rule. On the contrary, the purpose of the 1982 amendments was simply to provide students with one set of uniform, clear disclosures for student loans. In sum, the principles of statutory construction require that we disregard amendments to the TILA and Regulation Z made subsequent to the Rule's issuance in 1975, in construing references to them in the Holder Rule.

We are aware that one federal appellate court has held that "loans made, issued or guaranteed under the (Higher Education Act of 1965) have been exempted from the FTC rule on preservation of consumer defenses." *Veal v. First American Savings Bank*, 914 F. 2d 909, 914 (7th Cir. 1990) The quoted material, which was included in an opinion that dealt with a broad range of alleged wrongdoing and legal issues,[8] was set forth without any discussion whatsoever.[9] We respectfully

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[8] The case involved charges of breach of contract, breach of fiduciary duty, fraud, negligence, and violation of the Indiana Deceptive Practices Act and the Higher Education Act of 1965. *Id.* at 912. The opinion also discussed the Indiana UCC and numerous rules issued by the Department of Education. *Id.* at 913-14.

[9] The quoted statement was followed only by two citations. First, it cited 15 U.S.C. §1603(6), the TILA exemption that was added in 1982. Second, it cited 16 C.F.R. §226.3(f), a nonexistent regulation.

disagree, based on the foregoing detailed analysis that (1) the Commission covered student loans when it issued the Rule in 1975 and (2) Congress did not reduce the Rule's scope when it amended the TILA in 1982.

This letter constitutes informal staff opinion that is not binding on the Commission.

Sincerely,
Jean Noonan, Associate Director
for Credit Practices

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, DC 20580

February 11, 1993

Jonathan Sheldon, Esquire
National Consumer Law Center
11 Beacon Street - #821
Boston, Massachusetts 02108

Dear Mr. Sheldon:

This responds to your recent inquiries to my staff concerning the documentation of federally guaranteed student loans in accord with the Commission's Trade Regulation Rule concerning Preservation of Consumers' Claims and Defenses ("Holder Rule" or "Rule"). It is our opinion that all documents evidencing student loan transactions (which you advise are usually promissory notes to the lender) that are covered by the Holder Rule must be drafted to comply with its terms, specifically to include the provision (sometimes called the "Holder notice") that it mandates.

The essence of the Holder Rule is the requirement that any seller of goods or services must include the required clause in the documents evidencing the obligation (16 C.F.R. § 433.2) to provide that if the consumer has a good defense against paying the seller, he or she can defend a claim by the lender on the same basis. There is simply no other way for a provider of goods or services to comply with the Rule than to include this provision in each such document.

It continues to be the Commission staff's opinion that federally guaranteed student loans are not exempt from the

Rule, for the reasons set forth in detail by my predecessor, Jean Noonan, in a letter to you dated July 24, 1991. Those views were subsequently ratified by the Commission in a notice terminating its review of the Holder Rule under the Regulatory Flexibility Act on July 29, 1992 (57 FR 28814, 28815 n.ll). Furthermore, the reasoning in the July 1991 letter was followed by Judge Richey in *Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1250-51 (D.D.C. 1992), the only significant judicial opinion we know of that contains legal analysis of this issue.

Where the Rule applies to an educational loan, therefore, the school must include the required clause (Holder notice) in the loan documents. As you are aware, the Rule is inapplicable to not-for-profit schools, which are beyond the regulatory jurisdiction of the Commission under the Federal Trade Commission Act. 15 U.S.C. § 44. Also, if the consumer is not referred to the lender, and the lender is not affiliated with or otherwise has no business arrangement with the school, the Holder Rule will not apply by its own terms. 16 C.F.R. § 433.1(d). In all other cases, the Rule will be in force and require the loan document form to include the necessary provision.

Finally, you inquired about the permissibility of a standard form promissory note that would include the clause required by the Holder Rule, but would allow the lender or seller to strike it out where it was not applicable. We see no reason why this would in any way contravene the Holder Rule.

This letter constitutes an informal staff opinion that is not binding on the Commission.

Yours truly,
David Medine
Associate Director for Credit Practices

Supreme Court, U.S.
F I L E D
OCT 1 1999
OFFICE OF THE CLERK

No. 99-395

IN THE

Supreme Court of the United States

VANESSA ARMSTRONG,

Petitioner,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENTS EDUCATIONAL CREDIT MANAGEMENT CORPORATION AND CALIFORNIA STUDENT LOAN FINANCE CORPORATION AND BANK OF AMERICA, N.A.

HENRY WEINSTOCK
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(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

Whether the 1988 statutes and regulations governing the federal Guaranteed Student Loan Program preempt a claim based upon alleged school misconduct brought under D.C. Code § 28-3809(a) to cancel a student loan obtained in 1988, where the student loan was both approved by the United States Department of Education and contained no language allowing the assertion of school-based claims against holders of the promissory note.

PARTIES TO THE PROCEEDINGS BELOW AND STATEMENT PURSUANT TO RULE 29.6

Respondents California Student Loan Finance Corporation, Bank of America NT&SA, now known as Bank of America, N.A., and Educational Credit Management Corporation accept the Petitioner's recitation of the Parties to the Proceeding below, but add to the statement the following corporate disclosures.

California Student Loan Finance Corporation is a California nonprofit public benefit corporation. It has no parent corporation nor any publicly held company owning 10% or more of its stock.

Bank of America, N.A., is a wholly owned subsidiary of Bank of America Corporation, a publicly held corporation.

Educational Credit Management Corporation is a Minnesota not for profit corporation. It has no parent corporation nor any publicly held company as a member.

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STATEMENT OF THE CASE

In the decision below, the District of Columbia Circuit held that the federal law governing the Guaranteed Student Loan Program ("GSLP") as it existed in 1988 preempted the Petitioner's claim to have her 1988 student loan declared unenforceable under a portion of the District of Columbia Consumer Protection Act due to the alleged misconduct of the school she chose to attend with the proceeds of that loan. (Petitioner's Appendix at 15a-16a). In reaching its decision, the D.C. Circuit specifically recognized that changes to the program which occurred in 1992 and 1993 would require a different result if this case involved a loan made after those changes were enacted. (Petitioner's App. at 6a).

As will be shown below, the Petitioner's Petition for a Writ of Certiorari should be denied, because none of the suggested bases for granting the Petition which are articulated in Rule 10 of the United States Supreme Court Rules are present here. Effective January, 1994, the United States Department of Education ("DOE") required all GSLP lenders to use a standard form promissory note containing contractual language allowing student loan borrowers to raise school-based misconduct claims and defenses in certain circumstances. This new requirement has rendered the preemption issue asserted in this case moot for loans made within the last five and a half years. Consequently, there simply is no "important issue" involved in this case. Moreover, contrary to the Petitioner's arguments, the D.C. Circuit's ruling did not conflict with any prior decisions of this Court, nor with any decisions of any other Circuit Court of Appeals. In fact, every appellate court which has addressed the issue before the Court has consistently rejected the far-reaching relief sought by the Petitioner.

A. The Guaranteed Student Loan Program

The Guaranteed Student Loan Program ("GSLP") was established pursuant to the provisions of the Higher Education Act of 1965 ("the HEA"), 20 U.S.C. § 1071, *et seq.* (1988).[1] The HEA provides a comprehensive federal scheme which governs the guaranty agency portion of GSLP.[2] Under that program, lenders use their own funds to make Guaranteed Student Loans ("GSLs") to eligible students. These loans are guaranteed against default by "guaranty agencies," which are either state agencies or private not-for-profit entities which are established to administer and guarantee student loans. 20 U.S.C. § 1078(c) (1988). In the event a student defaults in repaying his or her loan, a guaranty agency pays the holder of the loan under the terms of its guarantee. At various times, the holder of

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1. In 1992, the GSLP program was renamed the "Federal Family Education Loan Program." Pub. L. No. 102-325, § 411, 106 Stat. 510 (1992). The Circuit Court's opinion used the name of the program as it existed in 1988, which will be followed in this response.

2. At the time the plaintiff obtained her loan in 1988, the GSLP included the guaranty agency program and the Federally Insured Student Loan Program (the "FISLP"). 20 U.S.C. § 1071(a) (1988); 34 C.F.R. § 682.100(a) (1988). The loans at issue here were made under the guaranty agency program, not the FISLP. A primary distinction between the two programs is that under the guaranty agency program, an independent guaranty agency insured the loans; under the FISLP, the Department of Education extends a guarantee to the lender to protect it against a borrower's default. The FISLP is only authorized to operate in states not served by a guaranty agency program or, in limited circumstances, in states in which a guaranty agency program does not serve all eligible students. 20 U.S.C. § 1071(a)(1)(B) (1988); 34 C.F.R. § 682.100(a)(3) (1988).

the student loan may be different than the original lender, as there are secondary market entities, such as respondent California Student Loan Finance Corporation ("CSLFC"), a California non-profit secondary market, which purchase loans from lenders, thereby providing additional funds for lenders to make student loans. As a tax exempt secondary market, CSLFC is legally obligated to purchase GSLs of any eligible student from lenders on a nondiscriminating basis, i.e., on the same terms, for all eligible students, without regard to the student's choice of school. 20 U.S.C. §§ 1087-1(e)(2)(D), (e), and (f) (1988); 34 C.F.R. § 682.840 (1988).

After a guaranty agency pays the holder of the loan under the terms of its guarantee, the guaranty agency obtains possession of the loan and is obligated to pursue collection efforts against the defaulting borrower. 34 C.F.R. § 682.102(c) (1988). The guaranty agency is reimbursed on a sliding scale for the funds it expends on lender's claims pursuant to its reinsurance agreement with the United States Department of Education ("DOE").

Institutions of higher education and vocational schools, as defined in the HEA, are entitled to participate in the GSLP. The HEA contemplates participation in the GSLP by all types of institutions of higher education. Under the HEA, "institutions of higher education", including "vocational schools", are schools accredited by a nationally recognized accrediting agency approved by the DOE or, where there is no agency, by a State-recognized agency or an advisory committee approved by the DOE. 20 U.S.C. §§ 1085(b)(5) and (c)(4) (1988).

In order to participate in the program, a school must first obtain a certification from the DOE that the school qualifies

as an "eligible" school. 34 C.F.R. § 682.600(a)(1) (1988); *see also* 20 U.S.C. §§ 1085(a)-(c) (1988). To obtain that certification, the school must meet the DOE standards governing the eligibility of the educational programs, which require the school to be accredited by a nationally recognized accrediting agency and licensed by the State in which it is located. 34 C.F.R. § 668.7 (1988). Lenders and guaranty agencies do not participate in designating schools as eligible to participate in the program. After certification by the DOE, the school must enter into a written program participation agreement with the DOE. 34 C.F.R. § 682.600(a)(2) (1988). Neither the guaranty agency nor the lenders are parties to the program participation agreement.

Only after all the foregoing steps are completed can a school's prospective students obtain GSLs. Typically, a borrower obtains a GSL by obtaining an application from his or her chosen school, completing the application, and giving the application to the school. The school then certifies it and forwards it to a participating lender. 34 C.F.R. § 682.102(a) (1988). Certification consists of the school certifying the borrower's eligibility for a loan, the student's estimated cost of attendance, and the student's estimated financial assistance. 34 C.F.R. § 682.603 (1988). The student rarely has any face-to-face contact with the lender. *See* 54 Fed. Reg. 24125 (June 5, 1989) (comments of the DOE stating that lenders have no responsibility for in-person counseling of borrowers since they often have no face-to-face contact with borrowers). In the event that a participating school engages in misrepresentations to students about its programs, the DOE can take steps against the wrongdoing school by fining the school, or suspending, limiting or terminating the school's participation in the program. 34 C.F.R. § 668.71-.75 (1988).

After accepting a GSL, a borrower is required to repay that loan in accordance with the terms of the loan. 34 C.F.R. § 682.102 (1988). Prior to 1994, the terms of GSL loans, such as Petitioner's loan, were set forth in form promissory notes that were prepared by guaranty agencies and reviewed and approved by the DOE. 34 C.F.R. § 682.401(d)(1) (1988). Without approval by the DOE, the form promissory note could not be modified by lenders. 34 C.F.R. § 682.206(d)(2) (1988).

Failure to make installment payments when due for 180 days constitutes a "default" of the debtor's obligation, 34 C.F.R. § 682.200 (1988), entitling the holder to reimbursement from the guaranty agency. 20 U.S.C. § 1078(c) (1988); 34 C.F.R. § 682.102 (1988). After the guaranty agency reimburses the holder of a defaulted loan, the agency is obligated to pursue collection efforts against the borrower. 34 C.F.R. § 682.102(c) (1988).

Lenders participating in the GSLP are statutorily prohibited from discriminating against any applicants in providing GSL loans. 20 U.S.C. § 1071(a)(2) (1988). In the event a lender fails to comply with the statutes and regulations governing the program, the DOE can take steps to suspend, limit or terminate the lender's participation in the GSLP. 34 C.F.R. § 682.700, *et seq.* (1988). Similarly, the HEA specifically provides that the agreement between the DOE and a guaranty agency shall set forth adequate assurances that the guaranty agency will not engage in any practice which discriminates against borrowers or which results in a denial of a borrower's access to loans because of his or her attendance at a particular eligible institution within the area served by the guaranty agency. 20 U.S.C. § 1078(c)(2)(F) (1988).

Prior to 1992, the only specified bases under the GSLP for discharging a GSL was if the borrower died, became disabled or received a bankruptcy discharge. 20 U.S.C. § 1087 (1988); 34 C.F.R. § 682.402 (1988). In 1992, Congress amended the HEA to allow borrowers to seek discharges of GSLs received on or after January 1, 1986 which were used to attend an eligible institution that either (1) closed and thereby prevented the borrower from completing the program, or (2) falsely certified the borrower's eligibility to borrow under the GSLP. Pub. L. No. 102-325, sec. 428, 20 U.S.C. § 1087(c). At the same time, Congress made schools with excessive default rates ineligible to participate in the GSLP. Pub. L. No. 102-325, sec. 427(a), 20 U.S.C. § 1085(a)(2).

While it certainly has had the opportunity to do so, Congress has never stated, nor even suggested, that lenders and guaranty agencies should generally be subjected to claims of school misconduct, because neither lenders nor guaranty agencies are responsible to oversee the educational operations of eligible institutions. In fact, in promulgating new rules under the 1992 statutory amendments, the Secretary specifically noted that a school's misrepresentations about its educational program or placement services was not the type of "school malfeasance . . . that would permit a borrower to receive a loan discharge under the HEA." 59 Fed. Reg. 22471 (April 29, 1994).

In 1988, there were also no regulations which allowed a borrower to assert claims or defenses relating to school misconduct as a defense to repaying a GSL guaranteed by a guaranty agency. However, beginning in 1994 the DOE required, for the first time, the use of a standard promissory note which contained a contractual provision allowing student

loan borrowers who attend proprietary schools to assert school based claims or defenses against the holders of their loans in certain limited circumstances. *See* Pub. L. 102-325, § 425(e), 20 U.S.C. § 1082(m)(1) (portion of 1992 statutory amendments requiring the development of a "common application form and promissory note"). This contractual language was based on the Federal Trade Commission's "Holder Rule Notice" (hereinafter the "FTC Rule"), which is a notice the FTC requires to be included in certain consumer contracts under the provisions of 16 C.F.R. § 433.1. (Petitioner's App. at 6a). In such cases, this contractual language allows a GSL borrower to assert the same defenses he or she may have against the school directly against the holder of his or her loan in defense to a collection action brought to enforce the loan. Such language was completely absent from the petitioner's 1988 loan, the form of which had been approved by the DOE as required by 34 C.F.R. § 682.401(d)(1) (1988). Moreover, when the DOE began to require such language in student loan promissory notes, it provided lenders with advance notice and guidance several months beforehand, so that lenders could review their lending practices and/or discontinue making loans to students attending proprietary schools in order to protect themselves from school misconduct defenses. (Petitioner's App. at 6a-7a).

B. The Decision Below

Petitioner enrolled in a vocational school, NBS Automotive School in the District of Columbia, which she alleges engaged in misrepresentation to induce her and other students to enroll. (Petitioner's App. at 8a). NBS filed for bankruptcy in 1990. In 1991, plaintiff Armstrong brought this case against those parties that claimed a right to enforce her NBS loan, alleging that she and other students were entitled to raise NBS's fraud as a defense to enforcement of the student loans because of NBS's role in

the plaintiff's procurement of her loan. (Petitioner's App. at 8a).

In addition to asserting a number of claims that were also dismissed and are not involved in her Petition for Writ of Certiorari, the Petitioner asserted a claim relying on a District of Columbia statute which provides that "[a] lender who makes a direct installment loan for the purpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller if" the lender "acts at the express request of the seller" *and* "the seller participates in preparation of the loan instrument." D.C. Code § 28-3809(a)(1). (Emphasis added). This claim is the only claim at issue before this Court.

In a 1993 opinion dismissing this claim, the district court concluded that relief under the District of Columbia statute is preempted because federal law permits schools to perform certain loan making functions, and applying the D.C. statute would attach liability to "functions that clearly are contemplated by the HEA." *Armstrong v. Accrediting Council for Continuing Education and Training*, 832 F. Supp. 419, 430-31 (D.D.C. 1993).[3] The District Court also held that it would be inconsistent with the HEA to impose liability on an innocent loan purchaser such as CSLFC for alleged school misconduct because the HEA required CSLFC to purchase plaintiff's loan regardless of her choice of school. *Id.* 832 F. Supp. at 427. On appeal, the Circuit Court vacated

3. In reaching this conclusion, the District Court relied on another decision of the United States District Court finding the very same statute preempted by the Higher Education Act. *Jackson v. Culinary School of Washington*, 788 F. Supp. 1233 (D.C. Cir. 1993), *rev'd on other grounds*, 27 F.3d 573 (D.C. Cir. 1994), *vacated*, 115 S. Ct. 2573 (1995), *on reconsideration*, 59 F.3d 254 (D.C. Cir. 1995). There are no decisions to the contrary.

the judgment and remanded the case for the District Court to expressly consider whether it should exercise jurisdiction over the pendent state law claims under 28 U.S.C. § 1367, since petitioner's claim under federal law had been dismissed on other grounds. *Armstrong v. Accrediting Council for Continuing Education and Training*, 84 F.3d 1452 (D.C. Cir. 1996). (Petitioner's App. at 9a-10a, 27a). On remand, the District Court decided to exercise supplemental jurisdiction. *Armstrong v. Accrediting Council for Continuing Education & Training*, 950 F. Supp. 1 (D.D.C. 1996). Thereafter, the District Court once again granted defendants' motions to dismiss, but did not reach the issue of preemption of the District of Columbia statute because it agreed with defendants that a choice of law clause in the loan contract made the D.C. statute inapplicable. *Armstrong v. Accrediting Council for Continuing Education & Training*, 980 F. Supp. 53 (D.D.C. 1997). (Petitioner's App. at 29a-35a)[4].

On appeal, the District of Columbia Circuit held that regardless of whether the D.C. statute was applicable or not, federal law preempted D.C. Code § 28-3809. *Armstrong v. Accrediting Council for Continuing Education & Training*, 168 F.3d 1362 (D.C. Cir. 1999), *amended*, 177 F.3d 1036 (D.C. Cir. 1999). (Petitioner's App. at 1a-22a). The Circuit Court agreed with the Secretary of the DOE that this statute conflicted with "pre-1992 federal student loan policy," which, according to the D.C. Circuit, only allowed students to assert school misconduct defenses in the "limited

4. In her Petition, the Petitioner claims that "generally" state law allows borrowers to assert seller-based defenses against lenders who "cooperate in arranging student loans." (Petition at 6). This is not necessarily true; the laws of the fifty states vary considerably. Here, once the district court decided D.C. law did not apply, the plaintiff could not assert such a claim under California law.

circumstances" where the school "originated" the loan for the lender. (Petitioner's App. at 16a). The D.C. Circuit held that imposition of liability upon lenders who merely permitted schools to participate in the preparation of loan documents, as provided for under D.C. Code § 28-3809(a), would conflict with the GSLP's purpose "to make student loans attractive to private lenders by protecting them from the financial consequences of student default." (Petitioner's App. at 16a).

In her Petition for a Writ of Certiorari, the Petitioner contends that the District of Columbia Circuit's opinion asserted that the source of this preemptive federal policy was a decision by the staff of the Federal Trade Commission to not enforce the FTC Holder Rule with respect to student loans during the period from 1982 to 1992. (Petition at 12-13). This contention by the Petitioner is not accurate. While the D.C. Circuit did analyze the applicability of the FTC Rule to the Petitioner's student loan, it did so in rejecting the Petitioner's claim that she could "imply" the language of the FTC Rule into her note even though such language was not contained within the note. (Petitioner's App. at 12a-13a). In contrast, in holding that the Petitioner's claim under D.C. Code § 28-3809 was preempted, the D.C. Circuit did not look to or rely upon the FTC Rule at all; it looked only to the Higher Education Act and the Department of Education's regulations and policies regarding the enforceability of student loans. (Petitioner's App. at 16a-17a). Consequently, the Petitioner's entire argument that the Circuit Court's preemption ruling was based on the decision of the FTC to not enforce the FTC Holder Rule with respect to student loans is inaccurate.

REASONS FOR DENYING THE WRIT

This Court should deny certiorari because none of the suggested bases for granting a writ which are articulated in Rule 10 of the United States Supreme Court Rules are present here. First, this case, does not involve an issue sufficiently vital or "important" to the public to warrant this Court's intervention. Second, contrary to the Petitioner's arguments, the D.C. Circuit's opinion is not "inconsistent" with any previous rulings of this Court, or the rulings of any other Circuit Courts of Appeal.

I. THIS PREEMPTION ISSUE, WHICH WAS RENDERED MOOT IN 1993 WHEN THE DEPARTMENT OF EDUCATION MANDATED INCLUSION OF FTC HOLDER NOTICES IN GSLP NOTES, IS NOT SUFFICIENTLY IMPORTANT TO WARRANT SUPREME COURT REVIEW

Supreme Court Rule 10 indicates that the Court will not exercise its discretion to review a decision unless it involves an "important" federal question. However, the D.C. Circuit's narrow ruling in this case is expressly limited to pre-1994 promissory notes that were not required to include the FTC Holder Notices. The Circuit Court repeatedly stated that GSLP borrowers have been entitled to assert school misconduct as a defense to loan repayment (assuming there is a referral or affiliation between the school and lender) since 1993, when the Department of Education began requiring inclusion of the FTC Holder Notices in all GSLP promissory notes. (Petitioner's App. at 2a, 6a, 11a). As the Circuit Court stated:

> Although federal student loan policy **now** recognizes school misconduct defenses against lenders who have "referral relationships" with for-profit schools, appellant obtained her loan in the late 1980s, a time when federal policy protected lenders from such defenses. (Petitioner's App. at 2a). (Emphasis added).

Consequently, for all future GSLP loans and loans made for the last five and a half years, this preemption issue is moot. Since the Department of Education has already given students prospectively the relief that plaintiff seeks to retroactively impose here, a reversal of the lower Court's rulings in this case would help petitioner; but few other students have unresolved claims of pre-1994 school misconduct. A reversal would have little practical effect for other students or future cases, and it is therefore not sufficiently important to warrant the intervention of this Court.

Petitioner attempts to magnify the significance of this decision by claiming that in a "significant portion" of the thousands of student loan collection proceedings, student loan borrowers allege school misconduct as a defense to collection and that the "federal courts have struggled with the question of whether the Higher Education Act preempts these state defenses. . . ." (Petition at 1-2). As an initial point, Petitioner offers no evidence to support her contention that school misconduct defenses are raised in many cases at all. Even if this were true, however, thanks to the Department of Education's 1993 mandate, the "struggle" by federal courts with preemption referred to by the Petitioner is history for all but the few parties still litigating the enforceability of superseded promissory notes. Discretionary Supreme Court review is generally reserved for vital and important federal issues, not academic ones. Petitioner has no evidence that any Court has struggled with these

preemption issues for loans made since 1993. Moreover, as discussed below, the federal courts have not really struggled with this preemption issue. Rather, federal courts have consistently held that the GSLP statutes and regulations preempt state law claims where, as here, they punish compliance with the GSLP requirements and conflict with its goals and policies.

The significance of this issue has diminished for other reasons as well. By the time that the Department of Education allowed borrowers to assert school-based defenses in post-1993 loans, Congress had already imposed a statutory amendment which allowed the Department of Education to terminate the eligibility of for-profit schools with high default rates — the very schools that generate misconduct claims — and thereby reduced the national student loan default rate to only 10.7%. (*See* Pub. L. 102-325, § 427(a), 20 U.S.C. § 1085(a)(2), Petitioner's App. at 5a-6a, and Joint Appendix below at 340). The net effect of these statutory and administrative changes is that while lenders are more legally vulnerable to future claims of school misconduct, the primary source of such claims — shoddy proprietary schools — has been eliminated.

Yet another reason to doubt the importance of the Circuit Court's discussion regarding preemption of D.C. Code § 28-3809 in this case is that it was unnecessary to the ultimate judgment of dismissal. As noted by the Circuit Court, petitioner's standard form promissory note "contained a choice of law clause that subjected the loan contract to the laws of the state of the lender, in this case California." (Petitioner's App. at 8a). Consequently, the District Court held that Armstrong had no claim under the District of Columbia CCPA because the choice of law clause made California law applicable. *Armstrong v. Accrediting Council of Continuing Education & Training*, 980 F. Supp. 53, 59-60 (D.D.C. 1997).

The Circuit Court chose not to determine the validity of the choice of law clause "because we again agree with the Secretary that Armstrong's state law cause of action conflicts with pre-1992 federal policy governing guaranteed student loans." (Petitioner's App. at 16a). Since the same judgment of dismissal is mandated by an adequate and independent state law ground, for the reasons discussed by the District Court and by respondents below, the Circuit Court's preemption ruling was not necessary to the judgment, was somewhat advisory, and therefore is not sufficiently important to demand a response from this Court.

II. THE RULING BELOW IS NOT IN CONFLICT WITH THE DECISIONS OF THIS COURT OR ANY OTHER CIRCUIT COURT

A. The Ruling Below Is Not In Conflict With This Court's Decisions On Preemption Of State Law

The Petitioner argues that certiorari should be granted because the preemption ruling of the Circuit Court is "inconsistent" with this Court's prior decisions on preemption. (Petition at 14). As an initial point, Rule 10(c) of the United States Supreme Court Rules makes clear that more than "inconsistency" between the decision of this Court and the court to whom the writ is sought should be established by the Petitioner. That Rule specifically states that the Petitioner should establish that the decision of the lower court "decided an important federal question in a way that *conflicts* with relevant decisions of this Court." (emphasis added). That Rule goes on to state: "A petition for a writ of certiorari is rarely granted when the asserted error consists of . . . the misapplication of a properly stated rule of law."

Here, the Petitioner is arguing, at most, that the D.C. Circuit misapplied prior rulings of this Court, not that the D.C. Circuit's decision directly conflicts with any decision of this Court. Under the express standards of Rule 10, this should not be enough to justify granting the petition.

Moreover, contrary to the Petitioner's arguments, the District of Columbia's decision is not inconsistent with the prior decisions of this Court. In finding that D.C. Code § 28-3809 was preempted, the D.C. Circuit relied *on California Fed. Sav. & Loan Assoc. v. Guerra*, 479 U.S. 272, 281 (1987), in which this Court held that federal preemption can be implied where state law "actually conflicts with federal law." (Petitioner's App. at 14a). That is exactly the case here. As the D.C. Circuit recognized, under the GSLP "[T]he Secretary requires eligible schools to perform certain functions to facilitate student access to guaranteed loans, including giving students information on loan availability, certifying student eligibility . . . and forwarding applications to lenders." (Petitioner's App. at 3a). The D.C. Circuit correctly recognized that D.C. Code § 28-3809(a) did conflict with the GSLP, because it would impose liability upon lenders "who do no more than permit schools to participate in the preparation of the loan instruments at the school's request." (Petitioner's App. at 16a).

The GSLP was created with the intention that lenders would usually have no face-to-face contact with borrowers. *See, e.g.*, 54 Fed. Reg. 24125 (June 5, 1989) (comments of the DOE recognizing that schools, not lenders, had to counsel borrowers because lenders often have no face-to-face contact with the borrower). Such "long distance lending" enhanced the ability of participating lenders to make funds available on a nation-wide basis to borrowers attending eligible schools

of their choice. Therefore, the Circuit Court was correct in accepting the Secretary's position that state law claims such as the one at issue here, which imposed liability upon lenders merely because the seller participated in preparing the loan documents, are preempted.

In arguing that the D.C. Circuit Court's preemption ruling is "inconsistent" with prior rulings of this Court, the Petitioner first points to *Puerto Rico Consumer Affairs Dep't v. Isla Petroleum Corp.*, 485 U.S. 495 (1988). (Petition at 15). In that case, oil companies argued that even after the expiration of a federal statute controlling petroleum prices, state laws seeking to regulate such prices remained preempted. This Court held that there was no such preemption "in vacuo, without a constitutional text or federal statute to assert it." *Id.* 485 U.S. at 503.

Isla Petroleum provides the Petitioner with no support at all for her argument. There, as this Court recognized, Congress withdrew from "all substantial involvement in petroleum allocation and price regulation." *Id.* at 504. Here, Congress and the Secretary were and still are actively involved with regulating student loans through the GSLP.

It should be noted that in *Isla Petroleum* this Court also stated:

> Where a comprehensive federal scheme intentionally leaves a portion of the regulated field without controls, then the pre-emptive inference can be drawn — not from federal inaction alone, but from inaction joined with action. *Id.* at 503.

Here, there was a comprehensive federal scheme governing the GSLP in 1988 which did not impose any

liability for the misconduct of eligible schools upon participating student loan lenders and assignees. This "inaction" by Congress, and by the Secretary, supports the decision of the D.C. Circuit to preempt the application of D.C. Code § 28-3809, because that statute would impose liability where none was intended.

The express intent of the GSL program was to encourage private institutions to make, purchase, and guarantee loans to any eligible student attending an institution certified as "eligible" by the DOE. (*See, e.g.*, 1980 U.S. Code Cong. & Admin. N. p. 3168 ("increase loan availability by making the program more attractive to commercial lenders")). Plaintiff's claims would undermine that legislative purpose. Congress stated its "strong view that lenders ought to confine themselves to making lending decisions and leave education decisions to students, their families and institutions of post-secondary education." (1980 U.S. Code Cong. & Admin. N. p. 3178). That is why certification of eligible schools was delegated to the DOE and accrediting agencies. 20 U.S.C. § 1085(a)-(c) (1988); 34 C.F.R. § 682.600(a)(1) (1988). Lenders were given no supervisory or enforcement role.

The Petitioner also argues that the D.C. Circuit's ruling was inconsistent with this Court's decision in *Freightliners Corp. v. Myrick*, 514 U.S. 280 (1995). (Petition at 17). In *Myrick*, this Court held that in the absence of a federal standard requiring trucks to use antilock braking systems, a state common law negligence action against a trucking company for failure to use such a system was not preempted. The petitioner argues that "[a]s in *Myrick*, there is no federal standard to create a conflict" with her claim under D.C. Code § 28-3809. (Petition at 18).

Once again, the petitioner ignores the basis of the D.C. Circuit's ruling. As the Court expressly noted before analyzing the preemption arguments, the Secretary "requires eligible schools to perform certain functions to facilitate student access to guaranteed student loans." (Petitioner's App. at 3a). It is this federal requirement that is in conflict with a claim under D.C. Code § 28-3809, because that statute would impose liability upon lenders merely because the school was involved in "preparation of the loan instruments." Consequently, here, unlike in *Myrick*, there is ample federal regulation which directly conflicts with the petitioner's state law claim.

As for the petitioner's contention that state laws should not be preempted merely because they impose liability over and above what is authorized by federal law (Petition at 18), once again this argument misses the mark. This is not a case in which there is state liability in addition to that imposed under federal law; this is a case where the petitioner seeks to impose liability upon her student loan lender and assignees simply because they made her a loan in full compliance with a federal program that required the school to participate in the preparation of the loan. As the District Court of the District of Columbia recognized in *Jackson v. Culinary School of Washington*, *supra*, 788 F. Supp. at 1247, D.C. Code § 28-3809(a) is preempted because "[t]he GSL program requires the seller/school to participate in the preparation of the loan documents. . . . At bottom, . . . any school which followed the chain-of-command specified in the HEA would run afoul of D.C. Code § 28-3809(a)(1)."

B. The Decision Below Is Not In Conflict With The Decisions Of Other Circuit Courts Of Appeal

In arguing that the D.C. Circuit's ruling is "inconsistent" with the decisions of other "lower courts," the Petitioner makes a key concession by recognizing that the decisions to which she refers "do not present Circuit Court holdings in direct conflict." (Petition at 21). This concession should eliminate this entire argument as a basis for granting certiorari, because as Rule 10 of the United States Supreme Court states, certiorari will only be granted for "compelling reasons," such as when a United States court of appeals enters a decision "in conflict with the decision of another United States court of appeals on the same important matter."

Of course, the petitioner had to concede that there are no other Circuit Court opinions in conflict with the decision of the D.C. Circuit in this case. First, no other Circuit Court has ever addressed whether D.C. Code § 28-3809(a) is preempted, so no other Circuit Court decisions could conflict with the one at issue here on the question for which the petitioner seeks certiorari. Significantly, D.C. Code § 28-3809 was found to be preempted not only by the D.C. Circuit in this case, but also by the United States District Court for the District of Columbia in both this case, *Armstrong v. Accrediting Council for Continuing Education & Training*, 832 F. Supp. 419, 430-31 (D.D.C. 1993), and in *Jackson v. Culinary School of Washington*, 788 F. Supp. 1233, 1247 (D.D.C. 1992), *rev'd on other grounds*, 27 F.3d 573 (D.C. Cir. 1994), *vacated*, 115 S. Ct. 2573 (1995), *on reconsideration*, 59 F.3d 254 (D.C. Cir. 1995). There are no decisions to the contrary.

Two other Circuit Courts and one state Supreme Court have addressed preemption issues similar to those raised by

the petitioner in this case, and in all those cases the dismissal of such claims was affirmed. In *Veal v. First American Savings Bank*, 914 F.2d 909 (7th Cir. 1990), the Seventh Circuit reviewed a claim brought by a student loan borrower against her lender, guaranty agency and the Secretary seeking to rescind her student loan based upon the misconduct of the school she chose to attend with that loan. The District Court below had dismissed the plaintiff's claims on two grounds; first, because the plaintiff's state law claims were preempted, and second, because the plaintiff failed to state a claim under state law even in the absence of preemption. *Graham v. Security Sav. & Loan*, 125 F.R.D. 687, 693 (N.D. Ind. 1989). The Seventh Circuit declined to address the preemption issue, finding that the plaintiff failed to state a claim in any event. *Veal*, 914 F.2d at 909.

The petitioner tries to convince this Court that the Seventh Circuit decision in *Veal* is "inconsistent" with the D.C. Circuit's ruling in this case based upon a footnote contained at the conclusion of the *Veal* decision, which stated that a borrower sued by lenders in a state court could assert "any defenses available under state law that are applicable to his or her particular loan." *Id.* 914 F.2d at 914-15.

Contrary to the petitioner's contention, by making this statement in a footnote, the Seventh Circuit did not say anything inconsistent with the D.C. Circuit's preemption ruling. In *Veal*, the Seventh Circuit expressly declined to address preemption, and in the footnote the Court merely stated that procedurally, borrowers could assert "available" defenses in a state court collection action, i.e., those that were supported by law and not preempted. *Veal* is not inconsistent in any way with the D.C. Circuit's opinion in this case.

The petitioner's contention that the as yet unpublished decision of the Eleventh Circuit in the case of *Bartels v. Alabama Commercial College*, No. 98-8885 (11th Cir. June 29, 1999), 1999 U.S. App. LEXIS 19902, is inconsistent with the D.C. Circuit's decision in this case is equally unpersuasive. In *Bartels*, the Eleventh Circuit held, as did the D.C. Circuit here, that state law claims seeking to impose liability against lenders for school based misconduct were preempted to the extent they were based on "a relationship between the school and the lenders expressly contemplated, if not mandated, by the HEA." *Id.* slip. op. at 8. The "relationship" between the lender and school that was alleged to exist in *Bartels* was virtually identical to that alleged by the petitioner to exist here. *Id.* slip. op. at 8, n.6. Thus, the holding of the Eleventh Circuit in *Bartels* is not "inconsistent" with the D.C. Circuit's ruling in this case. In fact, it is nearly identical.

Finally, the petitioner claims that the decision of the Arkansas Supreme Court in *Bogart v. Nebraska Student Loan Program*, 313 Ark. 656, 858 S.W.2d 78, 81 (1993) is inconsistent with the D.C. Circuit's opinion in this case. Once again, the petitioner is mistaken. In *Bogart*, the plaintiff claimed that the school acted as the "agent" of the lenders because the lender and school had a long distance lending relationship. Based upon this "agency" theory, the plaintiffs sought to impose liability upon their lenders for the alleged misconduct of the school. The Arkansas Supreme Court ruled that this state law claim was preempted, because it sought to impose liability upon lenders for conduct that "coincide(s) precisely with the conduct outlined in the HEA necessary to put the loan into effect." *Id.* 858 S.W.2d at 81.

Thus, in *Bogart*, state law claims seeking to impose liability upon lenders for school based misconduct were

preempted to the extent they were based upon long-distance lending common under the program. This decision does not conflict with the decision of the D.C. Circuit in this case, it supports it.

CONCLUSION

For the foregoing reasons, Respondents request this Court to deny the Petitioner's Petition for Writ of Certiorari.

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No. 99-395

In the Supreme Court of the United States

VANESSA ARMSTRONG, PETITIONER

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a federal student loan program, which has since been modified, but which, at the time pertinent here, provided that a borrower could use school misconduct as a defense against a lender only if the lender had an "origination relationship" with the school, preempts a state law allowing a borrower to use the school's misconduct as a defense against the lender under a broader set of circumstances.

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BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 168 F.3d 1362. The court of appeals' per curiam order amending its opinion (Pet. App. 20a-22a) is reported at 177 F.3d 1036. The initial opinion of the district court is reported at 832 F. Supp. 419. The court of appeals' decision vacating the district court's initial opinion and remanding the case is unpublished, but the decision is noted at 84 F.3d 1452 (Table). The opinion of the district court after remand (Pet. App. 23a-58a) is reported at 980 F. Supp. 53.

JURISDICTION

The initial opinion of the court of appeals was issued on March 23, 1999. The court of appeals denied a

petition for rehearing and amended its opinion on June 4, 1999. The petition for a writ of certiorari was filed on September 2, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Guaranteed Student Loan Program (GSLP) was established by Congress as part of the Higher Education Act of 1965 (HEA), 20 U.S.C. 1071 *et seq.*[1] The GSLP encourages private lending to students who would otherwise be unable to finance their educations by offering private lenders federal subsidies and a loan guarantee backed by federal reinsurance. The GSLP also encourages student loans by facilitating the purchase of the loans in the secondary market. Those purchases provide primary lenders with cash to make additional loans. Pet. App. 2a-3a.

Several developments in the GSLP are relevant to this case. First, in the late 1970s and early 1980s, Congress and the Department of Education took steps to increase the number of loans to vocational school students, including removing the ceiling on the federal interest subsidy, increasing aggregate loan limits, and allowing loans to students who had not completed high school. Pet. App. 3a-4a. In addition, Congress excluded GSLP loans from the requirements of the Truth in Lending Act (TILA). Pub. L. No. 97-320, § 701(a), 96 Stat. 1538. As a result, between 1982 and 1991, the Federal Trade Commission (FTC) ceased applying to GSLP loans a regulatory requirement known as the Holder Rule. Pet. App. 4a, 20a-21a. If it applied to

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[1] In 1992, the GSLP was renamed the Federal Family Education Loan Program. In this brief, we follow the court of appeals' practice of using the name of the program as it existed in 1988. Pet. App. 2a, n.*.

GSLP loans, the Holder Rule would have required loan agreements arranged by a school to contain a notice preserving the borrower's ability to raise against the lender claims and defenses arising from the school's misconduct. 16 C.F.R. 433.2(a) (1988).

Although the FTC did not apply the Holder Rule to GSLP loans between 1982 and 1991, the Department of Education during that period considered lenders who sought to collect on GSLP loans subject to state-law defenses based on a school's misconduct if the school "originated" the loan. See 34 C.F.R. 682.200, 682.206(a)(2) (1988); Pet. App. 5a. The Department's regulations defined origination as a "special relationship" arising when the lender delegated to the school "substantial functions or responsibilities normally performed by lenders before making loans." 34 C.F.R. 682.200(b) (1988); 51 Fed. Reg. 40,890 (1986).

Under the Department's policy, lenders were subject to defenses based on a school's misconduct *only* when they had an origination relationship with the school (and under certain other limited circumstances not relevant here). See Letter from Acting Assistant Secretary Kenneth D. Whitehead to Hon. Stephen J. Solarz (May 19, 1988) (stating that "a student who borrows under the GSL program from a third party lender remains responsible for repaying the loan even if the school closes" unless an "origination relationship" exists between the lender and the school); 55 Fed. Reg. 48,327 (1990) (describing Secretary's "longstanding view" that, absent an "origination relationship" between the lender and the school, "a student who borrows under the GSL program from a third-party lender remains legally responsible for repaying the loan, even if the school fails to provide the student with the services purchased by the student"); 34 C.F.R.

682.604(f)(2)(iii) (1989) (providing that students should be counseled that they cannot raise school-related defenses on a loan "other than a loan made or originated by the school"); Letter from General Counsel Jeffrey C. Martin to Hon. Edward M. Kennedy (Oct. 4, 1991) (explaining Department's view that "banks should be afforded protection from potential liability under state law for school misconduct" except in "a few narrow circumstances"); 57 Fed. Reg. 60,304 (1992).

The statutory and regulatory changes had the desired effect of increasing student loans to vocational school students. There was, however, a simultaneous increase in loan defaults that caused the government to incur significant expense. Pet. App. 5a. In 1992, Congress made a number of reforms to the GSLP that were designed to remedy that problem. Of particular relevance here, Congress directed the Secretary to develop a uniform loan application form and promissory note for the program. See *id.* at 5a-6a. The uniform promissory note developed by the Secretary contained a clause that allowed a borrower to assert any claim or defense against a lender that it would have against a for-profit school, if the school had referred the borrower to, or was affiliated with, the lender. That clause effectively incorporated the Holder Rule into each note and accorded with an FTC determination during the previous year that the Holder Rule should apply to promissory notes related to GSLP loans. *Id.* at 6a.

2. This case concerns a $4000 GSLP loan made in 1988 by the First Independent Trust Company of California to petitioner Vanessa Armstrong to finance her education at NBS Automotive School. Pet. App. 24a-25a. The promissory note contained a choice of law clause that subjected the loan contract to California law. *Id.* at 8a. According to petitioner, the school made

misrepresentations to her to induce her to attend its program. *Ibid.* Petitioner alleges that the school prepared her loan application, specified the type and amount of the loan, selected the lender, and transmitted her completed application to the lender. *Ibid.* The loan was guaranteed by the Higher Education Assistance Foundation (HEAF).[2] *Id.* at 25a. Soon after the promissory note was executed, it was obtained by respondent Bank of America, as trustee for respondent California Student Loan Finance Corporation. *Ibid.*

Petitioner attended NBS until June 1989 and made regular payments on her loan. The school closed in 1990 and filed for bankruptcy. Of the more than $5000 that petitioner paid NBS, petitioner recovered $900 in the bankruptcy proceedings. Pet. App. 8a-9a.

3. a. Petitioner then initiated the current lawsuit against the holder and guarantors of the note and the Secretary of Education (in his official capacity as reinsurer of the note).[3] Petitioner seeks damages, restitution, and declaratory relief absolving her of her duties under the note. The gravamen of petitioner's suit is that NBS defrauded her and failed to provide her the education that it promised. In the district court, petitioner raised federal claims based on the Holder Rule and the Department's school-origination policy, as well as a number of state-law claims. Pet. App. 9a. The

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[2] In 1994, during the course of this litigation, HEAF dissolved, and its guarantee obligation with respect to petitioner's loan was transferred to respondent Education Credit Management Corporation. See Pet. App. 9a.

[3] Petitioner also made claims against the Accrediting Council for Continuing Education and Training, which accredited NBS. Because those claims were settled, they were not part of the appeal below and are not relevant to the petition. See Pet. App. 9a-10a.

only state-law ground relevant to this petition is petitioner's claim under D.C. Code Ann. § 28-3809(a)(1) (1981), which provides in relevant part that:

> A lender who makes a direct installment loan for the purpose of enabling a consumer to purchase goods or services is subject to all claims and defenses of the consumer against the seller arising out of the purchase of the goods or service if such lender acts at the express request of the seller, and * * * the seller participates in the preparation of the loan instruments.

Pet. App. 68a.

b. The district court dismissed petitioner's federal claims for failure to state a claim on which relief could be granted. *Armstrong* v. *Accrediting Council for Continuing Educ. & Training, Inc.*, 832 F. Supp. 419 (D.D.C. 1993). See *Jackson* v. *Culinary Sch. of Washington, Ltd.*, 27 F.3d 573, 586 (1994) (holding that the Department's origination policy does not give rise to a federal cause of action), vacated on other grounds, 515 U.S. 1139, reinstated in pertinent part, 59 F.3d 254, 255 (D.C. Cir. 1995). The district court dismissed petitioner's claims under D.C. Code Ann. § 28-3809(a)(1) (1981) on two bases. First, the court ruled that petitioner failed to state a claim under that statute because she failed to allege one of the statute's elements—that the lender acted "at the express request of the seller." 832 F. Supp. at 430. Second, the court held that, even if petitioner had stated a claim under Section 28-3809, that state-law provision would be preempted because it purported to impose liability on lenders "for actions mandated by Congress." *Id.* at 431.

c. On appeal, petitioner conceded that she had no federal claim. See Pet. App. 9a. The court of appeals for the District of Columbia Circuit vacated and remanded for the district court to make an express determination whether it would exercise its discretion to retain jurisdiction over the pendent state-law claims and to enter a declaratory judgment. See *id.* at 9a-10a (citing *Armstrong* v. *Accrediting Council for Continuing Educ. & Training, Inc.*, 84 F.3d 1452 (D.C. Cir. 1996) (Table) (unpublished opinion), *available in* 1996 WL 250412). The court of appeals instructed the district court that, if it retained jurisdiction, it should first consider the validity of the choice-of-law clause in the promissory note and determine whether District of Columbia or California law applied. Only then should the court determine whether the applicable state law was preempted by federal law. 1996 WL 250412, **2.

d. On remand, the district court first decided to retain jurisdiction over the pendent claims and to consider petitioner's request for declaratory relief. See *Armstrong* v. *Accrediting Council for Continuing Educ. & Training, Inc.*, 950 F. Supp. 1 (D.D.C. 1996). Following the court of appeals' directions, the district court then considered the choice-of-law question and held that petitioner could not rely on D.C. Code Ann. § 28-3809 (1981) because the promissory note contained a valid choice-of-law clause requiring application of California law. Pet. App. 34a-35a. Accordingly, the district court did not reach the question whether D.C. Code Ann. § 28-3809 (1981) was preempted by federal law. Pet. App. 36a.

e. The court of appeals affirmed. The court did not address the questions before it in the order that it had previously directed the district court to proceed. Instead, the court reserved judgment on the choice-of-

law question and held that, even if D.C. Code Ann. § 28-3809 (1981) would otherwise apply, it was preempted by federal law. Pet. App. 16a. The court of appeals explained that, at the time that petitioner's loan was made, "federal student loan policy was intended to make student loans attractive to private lenders by protecting them from the consequences of student default." *Ibid.* The program allowed students to raise state-law school-misconduct defenses only in limited circumstances, including "where there is a school-origination relationship." *Ibid.* Because D.C. Code Ann. § 28-3809 (1981) would allow students to raise school-misconduct defenses in a broader range of circumstances than those in which origination relationships existed, the state statute was preempted. Pet. App. 16a.

Petitioner now seeks this Court's review solely on the question whether federal law preempts D.C. Code Ann. § 28-3809 (1981). Pet. i.[4]

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. In addition, the question lacks substantial prospective importance because of intervening statutory and regulatory changes, and this case is not an appropriate vehicle to resolve the question in any event. This Court's review is therefore not warranted.

1. a. The court of appeals properly applied this Court's decisions holding that state law is preempted

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[4] Petitioner does not argue in this Court that NBS Automotive School "originated" her loan within the meaning of the applicable federal regulations. That fact-bound question would not, in any event, warrant the Court's review.

when it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *California* v. *ARC America Corp.*, 490 U.S. 93, 101 (1989); accord, *e.g.*, *Freightliner Corp.* v. *Myrick*, 514 U.S. 280, 287 (1995); *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941). And the court of appeals correctly held that D.C. Code Ann. § 28-3809 (1981) presented an obstacle to congressional purposes underlying the Guaranteed Student Loan Program (GSLP) at the time that petitioner's loan was made. At that time, the Department of Education, acting pursuant to its authority to implement the Higher Education Act of 1965 (HEA), 20 U.S.C. 1071 *et seq.*, had weighed the relative importance of (1) protecting borrowers from liability for GSLP loans used to attend schools that did not deliver promised training to their students, and (2) encouraging private lenders to make GSLP loans by protecting them from defenses based on the schools' actions. The Department had determined that to protect students, state-law school-based defenses could be used where a lender had a particularly close relationship (an "origination" relationship) with the school; but, to encourage lending, state-law school-based defenses could not be used in other circumstances. See pp. 3-4, *supra*. The court of appeals properly gave effect to that determination by ruling that, absent an origination relationship, state-law defenses such as D.C. Code Ann. § 28-3809 (1981) are preempted.

This case thus closely tracks this Court's seminal case involving preemption based on an obstacle to the accomplishment and execution of the full objectives of Congress. In *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), both the State of Pennsylvania and the United States had passed laws requiring registration of aliens. The federal statute did not require aliens to carry identifi-

cation cards and provided for punishment only of *willful* failure to register; in contrast, the Pennsylvania law required aliens to carry identification cards and provided for punishment of *any* failure to register. *Id.* at 59-61. The Court held that "Congress was trying to steer a middle path" between the need for some registration scheme and a desire not to impose overly harsh measures on aliens that might, inter alia, generate disloyalty. *Id.* at 73-74 & n.37. As a result, although compliance with both statutes was possible, the Court held that the Pennsylvania statute containing more strict requirements and harsher penalties was preempted because it stood as an obstacle to the accomplishment and execution of the full objectives of the federal scheme. See *id.* at 67, 74. Similarly, here, in implementing the HEA, the Department of Education tried to steer a middle path between protecting students and encouraging lending by allowing state-law school-based defenses only when a special, "origination" relationship existed. Application of laws such as D.C. Code Ann. § 28-3809 (1981) would have created an obstacle to the execution of that federal scheme by skewing its delicate balance and allowing state-law school-based defenses in a much broader range of cases.

b. Petitioner's principal objection to the decision of the court of appeals stems from a fundamental misreading of the court's opinion. Petitioner mistakenly states that the court found preemption based on "the FTC staff's decision not to enforce the FTC Holder Rule with respect to student loans during the period from 1982 to 1992." Pet. 12; see also Pet. 13, 14, 15. The court, however, did not determine that D.C. Code Ann. § 28-3809 (1981) was preempted because of the FTC's decision not to enforce its Holder Rule, but rather determined that the D.C. law was preempted because it

would frustrate "the Department's school-origination policy." Pet. App. 16a. The court of appeals held that federal law preempted the D.C. statute because "it would extend lender liability beyond school-origination relationships." *Ibid.* Petitioner's arguments that the FTC's failure to enforce the Holder Rule does not preempt state law (Pet. 14-19) are thus not relevant to the case at hand.

2. Contrary to petitioner's contentions, the decision of the court of appeals does not conflict with any decision of this Court. Petitioner incorrectly claims (Pet. 15-17) that the decision is inconsistent with *Puerto Rico Department of Consumer Affairs* v. *Isla Petroleum Corp.*, 485 U.S. 495 (1988). In *Isla Petroleum*, Congress had provided that presidential authority to regulate the allocation and pricing of petroleum products would terminate on September 30, 1981. *Id.* at 498. The respondent oil companies nonetheless contended that state regulations governing petroleum that were promulgated four and one-half years later were preempted by Congress's decision to decontrol petroleum prices. The Court noted that there was no "extant federal regulation that might plausibly be thought to imply exclusivity" and rejected the view that preemption could arise solely from legislative history without reference to either statute or regulation. *Id.* at 501. Because "Congress ha[d] withdrawn from all substantial involvement in petroleum allocation and price regulation," the Court concluded that there could be no preemption without an explicit statement of preemptive intent. *Id.* at 504.

Here, in contrast, the federal government actively regulated student loans and their repayment through HEA and the Department of Education's regulations. And the court of appeals properly concluded that giving

effect to D.C. Code Ann. § 28-3809 (1981) in the absence of an origination relationship would frustrate the Department's "pre-1992 federal student loan policy." Pet. App. 16a. Thus, petitioner's contention (Pet. 15) that the court of appeals' decision "does not identify any affirmative statutory or regulatory mandate as the basis for preempting state laws" is incorrect, and there is no conflict between that decision and *Isla Petroleum*.

Petitioner's assertion (Pet. 17-18) that the decision of the court of appeals conflicts with *Freightliner Corp.* v. *Myrick*, 514 U.S. 280 (1995), also lacks merit. In *Freightliner*, the Court held that state tort law imposing liability for failure to install anti-lock braking systems (ABS) in tractor-trailers was not preempted, because there was no federal regulation in effect either requiring or prohibiting ABS systems in those vehicles and no evidence that the federal regulatory agency decided that the vehicles should be free from state regulation on the subject. See *id.* at 286-287, 289-290. The Court concluded that "[a] finding of liability against petitioners [automobile manufacturers] would undermine no federal objectives or purposes with respect to ABS devices, since none exist." *Id.* at 289-290.

Here, in contrast, there was a federal policy concerning state-law defenses to GSLP loan repayment based on school misconduct. The Department of Education had determined that lenders should be subject to those defenses only in specified circumstances, such as when the school had so significant a role in the lending relationship that it "originated" the loan. See pp. 3-4, *supra*. The objective of that federal policy was to promote widespread access to student loans. Application in that context of D.C. Code Ann. § 28-3809 (1981) would undermine that federal objective

by allowing defenses based on school misconduct in situations in which the school's involvement in the lending relationship was not unusually extensive.

For the same reason, petitioner errs in contending (Pet. 18-19) that the decision of the court of appeals conflicts with this Court's cases allowing state law to impose liability greater than the liability imposed by federal law. Such cases, including *English* v. *General Electric Co.*, 496 U.S. 72 (1990), and *California* v. *ARC America Corp.*, 490 U.S. 93 (1989), address situations in which there is no conflict between the State's imposition of greater liability and federal law. Here, as in *Hines*, there is a conflict, because the federal scheme did not simply permit state-law school-based defenses in specified circumstances but *limited* state-law school-based defenses to those circumstances.[5]

3. There is no conflict among the courts of appeals on the question presented by petitioner, as petitioner herself admits. Pet. 21, 24. Petitioner nonetheless urges this Court to grant review on the basis of "divergent decisions emerging from the lower courts." Pet. 21. In fact, the lower courts have uniformly found state laws comparable to the one at issue here to be preempted. This Court's review is not warranted based on petitioner's assertion that those courts apply different rationales in reaching their uniform results.

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[5] Petitioner's reliance (Pet. 20-21) on *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63 (1966), and *United States* v. *Yazell*, 382 U.S. 341 (1966), is also misplaced. Those decisions concern the issue whether a court should rely on state law or fashion a federal common law rule when the court must fill in the interstices of a federal program. They do not concern the question presented here—under what circumstances federal law preempts conflicting state law.

Petitioner does not cite any case the holding of which is contrary to the court of appeals' decision here. Petitioner inaccurately asserts (Pet. 21-22) that *Veal* v. *First American Savings Bank*, 914 F.2d 909 (7th Cir. 1990), "states that state law defenses are not preempted." In the *Veal* case, the district court had held that the state-law remedy of rescission *was* preempted by federal law. See *id.* at 911; *Graham* v. *Security Sav. & Loan*, 125 F.R.D. 687, 692 (N.D. Ind. 1989). The district court also had held that plaintiffs failed to state a claim and that the HEA does not create a private right of action. *Id.* at 693. The court of appeals *affirmed* solely on the ground of failure to state a claim. *Veal*, 914 F.2d at 911. As a result, that court never addressed preemption.

Moreover, the footnote from *Veal* on which petitioner relies simply states that, "if sued by a Lender in state court for collection of one of these loans, each of these plaintiff students would be entitled to assert any defenses *available* under state law *that are applicable to his or her particular loan.*" 914 F.2d at 915 n.7 (emphasis added). That footnote reflects the fact that the HEA does not preempt *the entire field* of loan defenses. See 832 F. Supp. at 429 ("HEA does not preempt all relevant state law"). Therefore, state-law defenses may be "available" to student debtors and "applicable" to the students' loans to the extent those defenses do not actually conflict with federal law. Thus, apart from the fact that the footnote was not part of the holding in *Veal*, it is consistent with the decision in this case.

Petitioner also mistakenly claims (Pet. 22-23) that *Bartels* v. *Alabama Commercial College*, 189 F.3d 483 (11th Cir. 1999) (Table), petition for cert. pending, No. 99-540, is inconsistent with the D.C. Circuit's decision in

this case. Like the D.C. Circuit here, the Eleventh Circuit in *Bartels* held that the state defenses at issue were preempted by federal law.[6] Petitioner's contention that the reasoning in *Bartels* would lead the Eleventh Circuit to find preemption in circumstances in which the D.C. Circuit would not find preemption does not warrant this Court's review of petitioner's case. Petitioner would fare no better under the Eleventh Circuit's purportedly broader view of preemption. Moreover, this Court "reviews judgments, not statements in opinions," *Black* v. *Cutter Labs.*, 351 U.S. 292, 297 (1956), and the judgment in *Bartels* is consistent with the judgment here.

Finally, petitioner incorrectly implies (Pet. 23-24) that *Morgan* v. *Markerdowne Corp.*, 976 F. Supp. 301 (D.N.J. 1997), *Tipton* v. *Secretary of Education*, 768 F. Supp. 540 (S.D.W.Va. 1991), and *Bogart* v. *Nebraska Student Loan Program*, 858 S.W.2d 78, 81 (Ark. 1993), are inconsistent with the D.C. Circuit's decision in this case. All of those cases hold state claims preempted by the HEA and do not conflict with the decision here. *Morgan*, 976 F. Supp. at 319 ("[R]egulatory provisions specifying the consequences of an origination relationship establish the consequences of lender-school relationships. To allow states to impose greater liability would frustrate the purposes and objectives of the HEA."); *Bogart*, 858 S.W.2d at 81 (state-law defense based on agency relationship between lender and school preempted by HEA and implementing regulations); *Tipton*, 768 F. Supp. at 558 (state-law defense based on relationship between school and bank that resulted

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[6] Indeed, counsel for petitioner here has also filed a petition for a writ of certiorari on behalf of the student borrowers in *Bartels*, No. 99-540.

from actions dictated by HEA and implementing regulations preempted).

4. In any event, the question presented by petitioner lacks substantial prospective importance because statutory and regulatory changes made in 1992 and later years have eliminated the issue from more recent loans and provide alternative relief for many earlier loans. As a result of the 1992 amendments to the HEA, all GSLP loans issued during or after 1994 contain a clause that effectively incorporates the Holder Rule. Pet. App. 6a; see p. 4, *supra*. In addition, 20 U.S.C. 1087(c), enacted in 1992 and amended thereafter, provides for the discharge of a GSLP loan made in or after 1986 if the student is unable to complete a program due to school closure, the school falsely certified the student's eligibility, or the school failed to make a refund owed to the lender. Thus, the question decided by the court of appeals is relevant only to the small number of cases in which a student asserts a state-law school-based defense against the lender, the loan was made before 1994, and none of the bases for discharge listed in 20 U.S.C. 1087(c) is present. Because those circumstances are so narrow, further review is not warranted.

5. Even if the question presented were sufficiently important, this case would not be a proper vehicle to address it, because the question posed to this Court was not addressed by the district court, was not necessary to the disposition of the case, and was improvidently reached by the court of appeals. As the court of appeals correctly noted in its earlier order, the choice-of-law question should have been decided before the preemption question. 1996 WL 250412, **2. That order of consideration would have allowed the court to avoid the preemption question, which is constitutionally based. *Fidelity Fed. Sav. & Loan Assoc.* v. *Cuesta*, 458 U.S.

141, 152 (1982). See, *e.g.*, *Jean* v. *Nelson*, 472 U.S. 846, 854 (1985) (courts should consider non-constitutional grounds for decision before reaching constitutional questions); cf. *Huron Portland Cement Co.* v. *City of Detroit*, 362 U.S. 440, 446 (1960) (Supreme Court decisions "enjoin seeking out conflicts between state and federal regulation where none clearly exists").

On the merits of the choice-of-law question, the district court correctly concluded that the loan's choice-of-law clause was operative and therefore California law, not District of Columbia law, applied (if it was not preempted). As the district court concluded, there was no merit to petitioner's argument that D.C. law should apply on the theory that the purpose of the choice-of-law clause was to frustrate the protections of D.C. law. See Pet. 32a-34a (noting that the choice-of-law clause employed standard language that was used nationally and approved by the Department). That conclusion necessitated dismissal of petitioner's claims under D.C. law, irrespective of preemption analysis, *id.* at 35a, 36a, and provides an alternate ground to support the judgment of the court of appeals.[7]

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[7] The district court also correctly found another independent non-constitutional basis for dismissing petitioner's claim under D.C. Code Ann. § 28-3809 (1981): petitioner failed to allege that her lender acted "at the express request of the seller," a prerequisite for the statute to apply. 832 F. Supp. at 430.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General

DAVID W. OGDEN
Acting Assistant Attorney General

BARBARA C. BIDDLE
JONATHAN H. LEVY
Attorneys

DECEMBER 1999

(5)

Supreme Court, U.S.
FILED
DEC 22 1999
CLERK

No. 99-395

IN THE
Supreme Court of the United States

VANESSA ARMSTRONG,
Petitioner,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari To The Court of Appeals for the District of Columbia Circuit

PETITIONER'S REPLY TO OPPOSITIONS TO PETITION FOR A WRIT OF CERTIORARI

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December 22, 1999

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Petitioner's Reply

As Respondents recognize, the decision below holds that remedies in an area that is traditionally governed by state law are preempted because they are an "obstacle" to federal objectives. Respondents urge this Court to let that ruling stand, even though there is a federal rule that endorses the objectives of the state law being preempted, and the source of the "conflict" that the Circuit Court identified is nothing more than an agency staff decision to temporarily suspend enforcement of this federal rule.

Respondents do not defend the rationale adopted by the Court of Appeals but, instead, advance an alternative ground that is not found in the opinion below. According to this theory, preemption arises from a Department of Education "determination" that state laws should be preempted unless they limit remedies to circumstances defined as "origination" in federal regulations. *See* Federal Opp. at 3, 9, 12; Educational Credit Management Corp. and Cal. Student Loan Finance Corp. and Bank of America Opp. at 9-10 (hereinafter, "Private Opp.").

Respondents' alternative theory, however, suffers from the same flaw as the Circuit Court's actual reasoning. There simply is no regulation, policy statement, or even interpretive rule that articulates any "determination" by the Department of Education (or the Federal Trade Commission) that state laws preserving borrower defenses must be preempted, or that it is the objective of federal law to immunize lenders from liability.[1]

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[1] Consequently, the question presented here is closely related to the issues currently pending before this Court in *Alexis Geier v. American Honda Motor Company,* No. 98-1811, where, among other issues, this (continued...)

As we show below, each of the Respondents' principle arguments against review is based on flawed premises and does not undermine the reasons for review presented in this Petition.

I.

The preemption issue presented here, and in the petition challenging the preemption ruling by the Eleventh Circuit, (*see Bartels v. Alabama Commercial College*, 189 F.3d 483 (11th Cir. 1999), petition for cert. pending, No. 99-540), warrant review by this Court because, as the Petition describes in detail, billions of dollars in loans have been issued under the federal student loan program, and litigation over outstanding loans now accounts for 60% of the civil cases brought by the United States. *See* Petition at 1-2. The Opposition Briefs in this case argue that these preemption rulings will have little impact because the standard form loan note mandated by statute and implemented by the Department in 1994 contains language comparable to the Federal Trade Commission's Rule on Preserving Consumer Claims and Defenses, 16 C.F.R. Part 433. *See* Federal Opp. at 16; Private Opp. at 13. This argument is mistaken for two reasons.

First, even if the preemption rulings are limited to pre-1994 loans, the impact is substantial. Over $700 million in federal student loans for attendance were issued during fiscal years 1983 through 1992 for students attending proprietary schools alone. *See* Dep't of Education, FY 1992 Loan Program Data

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[1](...continued)
Court is weighing the government's claim that state common law tort liability was implicitly preempted because it would frustrate the objectives of a federal standard that allowed manufacturers to use different types of restraint systems, even though the objectives that would allegedly be frustrated are not articulated in the regulation, and there is no indication that the regulation was intended to preempt common law liability.

Book, at 218-29.[2] Congress has entirely eliminated the statute of limitations on the enforcement of such student loans. *See* 20 U.S.C. § 1091a. Consequently, many of the loans at issue in federal suits or administrative enforcement actions are, like the loans at issue here and in *Bartels*, pre-1994 loans that are just now being enforced. *See, e.g., United States v. Hodges*, 999 F.2d 341 (8th Cir. 1993) (allowing enforcement of 1969 loan).

Second, the D.C. Circuit attributed preemption to a Federal Trade Commission staff decision not to enforce 16 C.F.R. Part 433 which was reversed in 1991 when the staff concluded that student loans are subject to this FTC Rule. *See* Pet. App. 4a-5a, 6a. However, both the Eleventh Circuit decision in *Bartels* and the Respondents' interpretation of the D. C. Circuit's opinion identify the source of preemption as Department of Education regulations on the consequences of schools assisting lenders as part of an "origination relationship." *See* Federal Opp. at 3; Private Opp. at 9-10; Pet. App. in *Bartels v. Riley*, No. 99-540 at 8a. Because these "origination" regulations remain in effect, *see* 34 C.F.R. § 682.206(a)(2) (1999), there is no basis to conclude, either from the these regulations or from any interpretation of the regulations by the Department, that their preemptive effect ended in 1994.

II.

None of the Respondents argues that this Court's decisions support the stated basis for the District of Columbia Circuit's opinion, namely that state law was preempted by the FTC staff's decision to not enforce 16 C.F.R. Part 433 with respect to guaranteed student loan program ("GSLP") loans. *See* Pet. App. at 4a ("Ending enforcement of the Holder Rule with

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[2] The default rates for borrowers who attended proprietary schools during this period are between 50-60%, while the rates for borrowers from other types of schools range from 13-31%. *Id.* at 66.

respect to GSLP loans thus had the effect of protecting lenders from claims and defenses students could raise against schools."). Instead, Respondents urge that the preemption of state law arises from a "determination" by the Department of Education that, unless the lender had an "origination" relationship with the school, state laws that allow borrowers to raise defenses based on misconduct by schools are preempted because they frustrate the objectives of federal law. *See* Federal Resp. at 9; Private Opp. at 9-10.[3]

Respondent's alternative interpretation, however, is just as inconsistent with this Court's preemption jurisprudence as reliance on the FTC staff's non-enforcement decision because there is no Department of Education regulation, policy statement or even interpretive rule that articulates any federal policy or objective that would be frustrated by such state laws. The Solicitor General's Brief asserts that the Department had a "policy" or made a "determination" that the program's objectives would be frustrated unless "lenders were subject to defenses based on a school's misconduct *only* when they had an

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[3]The Eleventh Circuit's opinion in *Bartels* also points to the "origination" regulations to justify its conclusion that state agency law is preempted. The Eleventh Circuit, however, does not cite any "determination" to preempt state law but, instead, asserts that state law must be preempted merely because the regulations permit lenders to use schools as their agents. Pet. App. in *Bartels v. Riley*, No. 99-540 at 8a. Moreover, the Secretary concedes that the Eleventh Circuit's opinion is "erroneous" to the extent that it suggests that the origination regulations are sufficient to preempt state law or that state-law defenses are preempted even when there is an origination relationship. *See* Federal Op. at 9. Of course, if the Eleventh Circuit's reasoning on this matter was erroneous, as the Solicitor General concedes, its holding was also erroneous because the plaintiffs in *Bartels* alleged that the school "originated" the loans at issue, *see* Pet. App. at 9a n.6, and the Department describes "origination" as an "agency" relationship. *See* Pet. Reply App. 94a.

origination relationship with the school (and under certain other limited circumstances not relevant here)." Federal Opp. at 3, 6, 9, 12 (emphasis in original). This assertion is not only inaccurate, but is directly contradicted by the Secretary's official statements on the issue. In 1990, the Department proposed, for the first time, a federal regulation on borrower defenses. 55 Fed. Reg. 48,324, 48,327 (1990). Two years later, the Secretary expressly rejected the proposal because:

> [T]he Secretary has decided that it is not desirable at this time to prescribe in regulations a uniform Federal rule regarding borrower defenses that would preempt state law otherwise applicable to [GSL] programs. The Department believes that the determination of whether a defense under state law is available to a borrower requires a case-by-case assessment of whether individual State laws would frustrate accomplishment of the federal objectives of the [GSL] program.

57 Fed. Reg. 60,280, 60,304 (1992).

Thus, contrary to the characterization in the Solicitor General's Brief, the Secretary expressly decided *not* to make a determination that the "origination" regulations define the only circumstances in which state-law based defenses do not frustrate federal objectives. Since this Court's decisions make clear that proposed regulations that have not been adopted have no preemptive effect, *see Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 171-72 (1978), the Department's *rejected* proposal certainly has no preemptive force.

The origination regulations themselves provide no support for the claim that the Department determined that state laws that permit defenses in any circumstances other than origination frustrate any federal objective. On their face, the regulations do not address preemption, but provide only that lenders may not disavow responsibility for a school's misrepresentations when

the lenders allow schools to perform substantial loan making functions. 34 C.F.R. § 682.200, 682.206(a)(2) (1988). The 1976 notice accompanying the first regulatory language on school-originated loans did not mention preemption, did not articulate any federal interest in immunizing lenders from state laws that protect borrowers when loan making responsibilities are delegated and, indeed, made clear that the objective of these provisions is to *discourage* lenders from delegating loan-making responsibilities to schools. 41 Fed. Reg. 4495, 4499-4500 (1976). The Department's 1986 notice adopting the origination regulations that applied to the loan at issue here, 51 Fed. Reg. 40889, 40936 (1986), also does not contain any indication that the Department concluded that the regulations have preemptive effect, or that there was a federal interest in immunizing lenders from defenses based on misconduct by schools acting on the lenders' behalf.

The Solicitor General's Brief also cites letters from Department officials to a Senator and Representative as support for his claim that the Department determined that lenders were subject to state law defenses "*only* when they had an origination relationship." Federal Opp. at 3-4. The letters are reproduced in the appendix to this Reply, and they show that the characterization of these documents in the Solicitor General's Brief is grossly inaccurate. Apart from the fact that agency correspondence with legislators does not establish federal "law" that could displace state statutes, the letters state that defenses based on misconduct by a school may be available in some circumstances, *including* where there is an origination relationship or the school acts as the lenders' agent.[4]

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[4] Indeed, the statements in these letters indicate that the claims presented in *Armstrong* and *Bartels* should not have been dismissed because

(continued...)

Neither letter states or suggests that the Department has used its regulatory authority to declare that the Department's origination regulations define the *only* circumstances in which state law defenses may be raised.[5]

In short, both the decision below and Respondents' alternative interpretation are based on the theory that state law is preempted because it would frustrate federal objectives – even though there is nothing in federal law that establishes an overriding federal interest in immunizing lenders from liability for fraud or other misconduct of schools that act on their behalf *unless* the lender and school are in an "origination relationship." The statute and the Department's regulations simply do not address the availability of defenses based on misconduct by schools, and this Court's rulings clearly establish that the silence of federal law on this issue does not provide a basis for preempting state laws that do address the issue. *See Freightliner Corp. v. Myrick,* 514 U.S. 280, 282 (1994); *Puerto Rico Consumer Affairs Dep't v. Isla Petroleum Corp.* , 485 U.S. 495, 501-503 (1988).

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[4](...continued)
Petitioners in *Bartels* alleged that the school acted as the agent for the lenders, and Petitioner in *Armstrong* alleged that the school originated the loan.

[5] The only other authority cited for the Secretary's claim that the Department had a "policy" or made a "determination," pursuant to the statute, to preempt state law, *see* Federal Opp. at 3, 9, are the 1990 notice of proposed rule making and 1992 rejection of the proposed rule discussed above, *see supra* at 4, and a 1989 regulation on counseling of students, 34 C.F.R. § 682.604(f)(2)(iii) (1989). The text of these documents does not support the Secretary's claims any more than the letters to legislators and, moreover, they could not support the ruling below because each was issued *after* Petitioner's loan was signed in 1988.

III.

The Private Respondents also argue that the preemption ruling below is correct because the student loan program is "'a comprehensive federal scheme'" that "intentionally leaves a portion of the regulated field without controls.'" Private Opp. at 16 (quoting *Isla Petroleum*, 485 U.S. at 503). But even the courts that have found preemption have rejected this claim, largely because the GSLP is an incentive program in which Congress has expressly preempted state law, but only on specified issues. Consequently, the District of Columbia Circuit and other courts that have analyzed the Private Respondents' claim have concluded that state law generally governs issues that are not covered by the express preemption provisions, including the defenses available to borrowers. *See* Pet. App. at 13a-14a (adopting analysis rejecting field preemption in *Jackson v. Culinary Sch.*, 27 F.3d 573, 580-81 (D.C. Cir. 1994), *vacated on other grounds*, 515 U.S. 1139, *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995)).

The Private Respondents also assert that the decision below is based on the conclusion that federal law not only permitted, but required, the school's involvement in the preparation of the loan. Private Opp. at 18. The decision below, however, clearly and correctly observes that the actions that schools are *required* to take in loan making under federal law are limited to giving students information, certifying student eligibility, and forwarding applications to lenders. Pet. App. at 3a. Federal law *permits* schools to become more extensively involved and perform functions such as preparing the loan instrument and securing the borrowers' signature, but it does not require that they perform such functions. *See* 34 C.F.R. § 682.206(a)(2). Neither the District of Columbia Circuit's decision here, nor the Eleventh Circuit's decision in *Bartels* accepted the claim that the schools' involvement in loan making was compelled by

federal law, but the Circuit Courts still found preemption because the schools' actions were permitted by federal law.

Indeed, although Respondents, the Circuit Court in this case, and the Eleventh Circuit Court in *Bartels* agree that state law is preempted, they cannot agree on the basis for finding such preemption. This unanimity on result but not on rationale strongly suggests that, like the unanimity of the federal courts of appeals on the preemption question in *Geier v. American Honda Motor Company* (*see* footnote 1), the preemption rulings reflect fundamental confusion about whether state law is displaced by what the Department of Education has done and, just as importantly, has *not* done in this area.

IV.

Finally, the Secretary asserts that, even if the preemption ruling below is incorrect, this Court should decline review because the Circuit Court "improvidently reached" the preemption issue without first resolving the question of whether the choice of law clause in the Petitioners' loan defeated the protections of the District of Columbia statute. Fed. Opp. at 16. The Secretary's argument is hypocritical, since he joined the other Appellees in opposing Petitioner's motion to certify this issue, and Respondents urged the Circuit Court to decide the preemption issue rather than certify the choice of law question (which is an issue of first impression in the District of Columbia, *see* Pet. App. at 29a) to the local court of appeals. *See* C.A. Docket, Federal Appellee's Opposition To Motion for Certification at 8 n.4 (Dec. 2, 1997). Moreover, the issue presented here is not one of constitutional interpretation that should be avoided in favor of non-constitutional grounds because the issue is not the meaning of the Supremacy Clause, but the construction of statutes and regulations.

At best, the Secretary's argument suggests that the decision below should be vacated and remanded with directions to the

Circuit Court to decide or certify the choice of law issue. The Circuit Court's preemption holding should not be left undisturbed on the basis of an alternative ground that the Circuit Court did not address (much less address in Respondents' favor) -- particularly where the choice of law issue can only be authoritatively answered through certification to the local court. The Secretary's argument concerning the choice of law clause is also inapplicable to the Eleventh Circuit's ruling in *Bartels* because there is no claim that any choice of law provision forecloses the agency claim in that action, which was dismissed by the Eleventh Circuit wholly on the basis that the student loan program preempts state agency law.

CONCLUSION

For the reasons stated above and in the Petition, this Court should review whether federal law preempts the application of state laws preserving borrower defenses to federally reinsured student loans.

Respectfully submitted,
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December 22, 1999

APPENDIX TO PETITIONER'S REPLY BRIEF

Letter from Acting Assistant Secretary Kenneth D. Whitehead to Hon. Stephen J. Solarz, May 19, 1988 ... 94a

Letter from General Counsel Jeffrey C. Martin to Hon. Edward Kennedy, Oct. 4, 1991 ..... 97a

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION

May 19, 1988

Honorable Stephen J. Solarz
House of Representatives
Washington, DC 20515

Dear Mr. Solarz:

This responds to your letter of February 10, 1988 to Secretary Bennett concerning former students of Adelphi Institute, Inc. who have outstanding Guaranteed Student Loans (GSL) for attendance at that school.

Many students borrowed under the Guaranteed Student Loan Program to finance their enrollment at Adelphi. These loans were made by various banks and were guaranteed by a number of guaranty agencies, including the Higher Education Assistance Foundation. Each of these guaranty agencies has a reinsurance agreement with the Department. The Department paid interest subsidies on each loan to a financially needy Adelphi borrower that was guaranteed by one of these agencies, and the Department reimbursed the agency for some or all of its losses with regard to those loans on which borrowers defaulted and the lenders filled claims on the respective guarantees.

If a loan is not legally enforceable, it is not reinsurable by the Department, and the Department would not encourage or require a lender or guaranty agency to attempt to collect such a loan. As a legal matter, however, a student who borrows under the GSL program from a third party lender remains responsible for repaying the loan even if the school closes, unless a relationship exists between the lender and the school that would make the school's failure to render educational services a defense to repayment of the loan to the lender. This kind of relationship can arise when the lender makes the school its agent for certain functions in the loan making process. The Department has termed such an agency

relationship an "origination relationship." 34 CFR 682.200.

As you are no doubt aware, students who attend the Gary, Indiana branch of Adelphi have filed a class action challenging the enforceability of several hundred loans guaranteed by HEAF. If the court finds that the school acted as an agent of the lenders and determines that the loans, for that reason, are wholly or partially unenforceable against the borrowers, the Department would honor that determination, and would regard these loans, to that extent, as not covered by reinsurance, and would neither attempt to collect them nor expect guranty agencies to collect them.

The Department has reviewed the write-off criteria and procedures submitted by the Higher Education Assistance Foundation, to which you referred. We cannot approve these standards as written, which includes a policy of forgiving the entire amount owed by borrowers who show some connection with a closed school, without regard to the enforceability of the loan, or, perhaps more importantly, whether the closing prevented the borrower from completing the course of education in which he or she was enrolled.

It would not be responsible to the public for the Department to adopt the kind of general policy of forgiveness on these loans described in the HEAF standards. To the extent, however, that any loan does not constitute a valid, legally enforceable obligation of a borrower, Federal policy has always recognized that such a loan should not be enforced against the borrower, and does not qualify for reinsurance payments from the Federal government.

The Department is currently developing write-off policies and plans to address in future regulations the handling of GSLs in school closing situations. However, at this point we do not expect that the write-off policies or the proposed regulations will provide for excusing repayment on a loan in the event that the school attended by the borrower closes, unless the loan was made or "originated" by the school, and the closure would constitute a legal defense to repayment of the loan.

We encourage students who do not receive what they pay for from a school to vigorously pursue their remedies against the school and any other related or responsible party. However, by agreeing that a school can participate in the GSL program, the Department does not endorse the quality of the educational program of the school, or guarantee that the school will continue to perform its educational program. The statutes under which the Department operates leave the assessment of educational programs to the accrediting agencies, the States, and local authorities with power to regulate the school. The Department can take certain enforcement action where misrepresentations are uncovered, but the extremely limited resources available to conduct this activity, and the thousands of schools that participate in the GSL program, make it unreasonable to expect that the Department can effectively police this field. The responsibility for questioning the quality of the courses and accuracy of the advertising of the schools in the GSL program thus rests with the State and privacy agencies specifically empowered to measure these factors and sanction improprieties, and, of course, with the students themselves. Based on these differences in roles, resources, and responsibilities, we do not believe that it is fair to routinely shift the burden of school failures to the shoulders of the Federal taxpayer.

I hope that this has clarified the Department's position regarding the forgiveness of loans under these circumstances. If you have any further questions, or wish any additional information, please contact Mr. William L. Moran, Division of Policy and Program Development, at 732-5217.

Sincerely,

/s/

Kenneth D. Whitehead
Acting Assistant Secretary

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE GENERAL COUNSEL

THE GENERAL COUNSEL

October 4, 1991

Senator Edward M. Kennedy
United States Senate
Washington, D.C. 20510-2101

Dear Senator Kennedy:

Secretary Alexander has asked me to answer your letter concerning the general legal question of whether, and if so when, students can avoid repaying their guaranteed loans owed to lenders on the ground that their school failed to deliver the promised educational services or otherwise defrauded the student. As you will recall, this issue was raise earlier this year by a West Virginia district court ruling in Tipton v. Secretary of Education.

I apologize for the delay in answering your letter. During this period, the Department has been giving this matter very careful review, and we have refined our position.

Briefly stated, it is the Department's conclusion that banks should be afforded protection from potential liability under state law for school misconduct in most situations, but that there are a few narrow circumstances where it is consistent with federal policy for banks to bear the financial consequences of school misconduct.

In our view, where the bank's relationship with the school in question is no more than one of receiving referrals or cooperating in the paperwork processing, the bank should not be held responsible for student misconduct, and contrary state laws that would let students refuse to repay their loans should be deemed preempted. That will cover standard lending practices in the student loan program, and addresses the principal contrary ruling in Tipton that gave rise to lender concerns.

On the other hand, we think that it is consistent with federal policy for a bank to be held accountable for school misconduct where (1) the bank had notice of prior serious student complaints which were not responsibly addressed by the school, (2) the bank and school are corporate affiliates, (3) the bank had delegated substantial pre-loan functions to the school, thus making the school its agent, or (4) the bank paid finders' fees to the school. Banks may avoid these situations, and potential risks, through their own prudent conduct; yet where they fail to do so, fairness to student borrowers and to taxpayers counsels that banks be held accountable for serious school misconduct.

We are setting forth the Department's position in more detail in a legal brief that we are filing today in the United States District Court for the District of Columbia, and I have enclosed a copy for your information. I have also enclosed answers to the three specific questions accompanying your letter.

If you have any further questions on this subject, we would be happy to meet with you or your staff.

Sincerely,

/s/

Jeffrey C. Martin